

April 18, 2008

To: Revenue and Transportation Interim Committee

From: Vern Hoven, CPA

**Problem:** Nonresidents not paying (reporting) their Montana real estate sales.

**Proposed solution by Department of Revenue:** Withhold a percentage of the gross sales on all real estate sales by nonresidents.

**Alternative proposed solution:** Require closing agents to send a copy of the IRS's Form 1099-S to the Department of Revenue. This should be coupled with trading audit information with the IRS.

“There is no such thing as a simple answer to a complex question if you wish to be fair.”

... *H.L. Mencken*

In taxation: the Montana legislator must either choose:

- fairness (which will result in a complex method of collecting tax) or
- simplicity (which will result in an unfair method of collecting tax).

### Testimony:

- I. I support a fair tax regime, one in which all taxpayers pay, and are held accountable for, the tax they owe. I will not support a tax system that allows the taxpayer to illegally “game” the system because the government has been so hand-tied that the knowledgeable feel comfortable they will not “get caught.” Nor will I ever support the “starve the beast” bankrupt philosophy.
  - A. With that said, the government should also not collect more tax than they are legally owed, especially by a system that forces the taxpayer to pay in advance and either file or “sue” for a refund in the following governmental fiscal year. This makes the government look like a slumlord that spends the refundable security deposit.
  - B. Additionally, passing laws which makes a government bureaucrat’s life easier by making the taxpayer’s life more difficult is an abhorrent short-term strategy that most successful politicians avoid . . . especially in Montana!

II. The problem: Director Dan Bucks has testified that an abnormal number of nonresidents are not reporting their Montana real estate sales. I, for one, laud the attempt to lower this number.

A. Director Bucks is coming to that conclusion by analyzing the Montana Realty Transfer Certificate Confidential Tax Document (attached). Trying to ascertain the number of *taxable* real estate transactions from the *total* real estate transactions as evidenced by the Realty Transfer Certificate *without* the seller's input, in my opinion, may be impossible. I'm sure that Director Bucks is *not* making up numbers. But, my experience is not agreeing with his conclusions.

1. The problem is his statistical analysis methodology cannot be independently determined as the information on the certificate is "confidential." Erroneously, or not, because no objective taxpayer or non-governmental organization will ever be able to verify the accuracy of these reports, his statistical analysis will be looked at with suspicion by his opponents (as they should). With that said, I am sure that Director Bucks is trying to ascertain an accurate noncompliance rate. But, we all would probably agree that Director Bucks has been a strong advocate of this cause, and I would want no less from him.

B. I'm not convinced that there are an abnormal number of nonresidents not reporting their Montana real estate sales.

1. The reason I say this is that the professional Montana tax preparer has not indicated, even "anecdotally," to me or to the Montana CPA Society, that there is a high level of noncompliance by nonresidents. Quite the opposite.

2. The 2008 IRS statistical data book reports an 86% compliance rate by individual taxpayers. In other words, only 14% are in noncompliance. Interestingly, almost all of noncompliance is underreported income, not overstated deductions. This supports Director Bucks assertion about noncompliant nonresidents. But, the compliance rate goes into the upper 90s percent when evidenced by either a W-2 or Form 1099.

3. Most CPAs nationally prepare *all* nonresident state tax returns at the same time as the taxpayer's Federal Form 1040. I pay taxes to both Montana and Idaho even though I am now a Washington resident. My tax package automatically prepares these returns simultaneously. If the taxpayer gives the preparer a Form 1099-S, the preparer knows the state the property is located in and *will* prepare the appropriate state returns.

a. I talked to a representative of H&R Block in Montana (who claims to prepare 11%-12% of all Montana tax returns) and he came to the same conclusion, i.e., we prepare all the nonresident returns.

b. So you're saying the taxpayer will just throw away the state return. That is probably not correct for two reasons:

(1) How many taxpayers would dare throw away the state return if we give them paper returns?

(2) 55.7% of all individual returns are filed electronically of which 71.5% were filed by tax practitioners. We would

95.5% compliance w/ 1099

*know* which client tells us to file Federal and not file Montana! And they are not so doing!

III. Director Bucks's solution, with numerous exceptions, is to propose a 2% gross sales withholding.

A. Applying a "sales tax" withholding system (e.g., 2% of gross sales price) within an income tax regime will provide substantial inequities.

1. In my opinion, too much cash will be collected at time of sale ... too often!

B. Example of inequity:

Income Tax Regime	#1	#2	#3	#4	#5
Sales Price	\$1,500,000	\$1,000,000	\$750,000	\$600,000	\$400,000
Basis	\$500,000	\$500,000	\$500,000	\$500,000	\$500,000
Gain	\$1,000,000	\$500,000	\$250,000	\$100,000	-\$100,000
Gross profit percentage	200%	100%	50%	20%	-20%
Tax (6.9% - 2% credit & ?% of itemized deductions)	\$49,000	\$24,500	\$12,250	\$4,900	-\$0-
Less: Withholding (2%)	\$30,000	\$20,000	\$15,000	\$12,000	\$8,000
Due to State ( or Refund)	\$19,000	\$4,500	(\$2,500)	(\$7,100)	(\$8,000)

Income Tax Regime	#1	#2	#3MFS	#4	#5
Sales Price	\$300,000	\$200,000	\$300,000		
Basis	\$200,000	\$100,000	\$100,000		
Gain	\$100,000	\$100,000	\$200,000		
Gross profit percentage	200%	100%	200%		
Tax (6.9% - 2% credit & ?% of itemized deductions)	\$4,915	\$4,915	\$8,589		
Less: Withholding (2%)	\$6,000	\$4,000	\$6,000		
Due to State (or Refund)	(\$1,085)	\$915	\$2,589		

C. The above tables indicate that too many taxpayers with low (or no) taxable sales

will have money collected ... which the Department of Revenue will have to pay back.

1. I ask this question, is it cheaper for the Department of Revenue to collect and keep the taxpayer's money or is it cheaper for the Department of Revenue to collect and pay the taxpayer back money that the taxpayer never owed the government in the first place?
2. Is this happening at the Federal level? Yes. I analyzed the IRS's 2007 statistical data book (IR-2008-43; 2007 IRS Data Book; FY 2007 IRS Enforcement and Services Tables; FY 2007 Enforcement Revenue and Individual Audits Chart). It showed that the
  - a. IRS collects 20% more than what is due, a \$248 billion tax-free loan to the IRS, resulting in 83% of individuals getting a refund! The IRS refunds 20% of the gross collections from individuals, e.g., \$248 billion refund of \$1.236 trillion in gross collections from individuals (Table 1). Of the 138 million individual taxpayers who filed tax returns during tax year 2007, more than 114.4 million received refunds (Table 7).
3. This is substantially more money being taken out of the economy that is being paid back by the Federal's \$168 billion "economic stimulus package." Excessive withholding takes money out of the economy for up to one year!

D. Most importantly, a withholding system will create a very complicated system as illustrated by the State of California's Form 593 (attached) which now applies to both residents and nonresidents and has numerous exceptions Form 593B through I and a booklet.

IV. Here are just some of the exceptions that must be provided to maintain a fair (but not simple) tax reporting system:

- A. How will the Department of Revenue provide exceptions for the numerous nontaxable transactions? E.g.,
  1. Gifts & transfers at death (§101)
  2. Spousal transfers, during marriage or in divorce (§1041)
  3. Transfers to (e.g, §721) and from (e.g, §731) partnerships and LLCs
  4. Transfers to (§351) and from corporations and mergers (§e.g, §368)
  5. Tax-deferred §1031 exchanges and §1033 involuntary conversions, including casualty losses
  6. Sales by non-profit organizations
  7. Transfers to trustors
- B. How will the Department of Revenue provide exceptions for those transactions that produce little or no gain in the year of sale: E.g.,
  1. Installment sales (§453)
    - a. Buyer must withhold on each payment with annual report to seller?
- C. How will the Department of Revenue provide relief for those real estate

transactions that don't produce gain? E.g.,

1. Taxpayers with offsetting carryover losses.
2. Sales that are sold for a loss.
3. Foreclosure sales on principal residences (Form 1099-C which are not eligible for Form 1099-S no-reporting relief)

V. In my opinion, the existing IRS Form 1099-S is a better reporting form than the Realty Transfer Certificate to indicate *taxable* real estate transaction, but, sadly, the Form 1099-S also reports numerous nontaxable transactions.

A. If the taxpayer does *NOT* give the preparer the Form 1099-S issued by the real estate closing agent, the IRS will send that taxpayer a *deficiency notice* assuming the entire sales price is the gain! That gets the attention of the taxpayer quickly!

1. All the State of Montana needs to do is send their own Notice of Deficiency assuming the entire sales price is the gain!
2. Alternatively, the State of Montana needs to request a copy of this IRS deficiency notice, which should be available through a Memorandum of Understanding. Numerous states already do this (see: Juvy Lyn Andrade Te Eng Fo v. Comm., TCS 2008-25).

#### **In Conclusion:**

A 2% of gross sales withholding system sounds like a sales tax system with a refund kicker; a tax system that is admittedly simple ... but not fair. I hope that this legislative body would support fairness over simplicity.

Thank you

# REALTY TRANSFER CERTIFICATE CONFIDENTIAL TAX DOCUMENT

The information contained in this certificate is confidential by Montana law. Unauthorized disclosure of this information is a criminal offense.

GEOCODE(S) \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 ASSESSMENT CODE(S) \_\_\_\_\_

**PART 1 - DATE OF TRANSFER (SALE)**  
 \_\_\_\_\_ (MM/DD/YYYY)

The Department of Revenue will change the name on ownership records used for the assessment and taxation of real property when this form is fully and accurately completed and signed. (Please read the attached instructions for assistance in completing and filing this form.) **Montana law requires this form be completed and may impose up to a \$500 penalty for failure to file a Realty Transfer Certificate (15-7-304, 305 and 310, MCA).**

Main Geocode: \_\_\_\_\_  
 Assessment Code Or Parcel #: \_\_\_\_\_

**PART 2 - PARTIES** Please complete this section in full. If additional space is required, please attach a separate page.

**SELLER (Grantor)**  
 Name \_\_\_\_\_ SSN or FEIN \_\_\_\_\_  
 Mailing Address \_\_\_\_\_  
 (Permanent) \_\_\_\_\_  
 City \_\_\_\_\_ ST \_\_\_\_\_ Zip \_\_\_\_\_ Daytime Phone \_\_\_\_\_

**BUYER (Grantee)**  
 Name \_\_\_\_\_ SSN or FEIN \_\_\_\_\_  
 Mailing Address \_\_\_\_\_  
 (Permanent) \_\_\_\_\_  
 City \_\_\_\_\_ ST \_\_\_\_\_ Zip \_\_\_\_\_ Daytime Phone \_\_\_\_\_  
 Mailing Address \_\_\_\_\_  
 for Tax Notice \_\_\_\_\_  
 (if different) City \_\_\_\_\_ ST \_\_\_\_\_ Zip \_\_\_\_\_  
 Transfer to Trustee, Custodian, or other Representative:  
 Trust FEIN \_\_\_\_\_  
 Minor SSN \_\_\_\_\_

**PART 3 - PROPERTY DESCRIPTION** Please complete fully. If additional space is required, please attach a separate page.

Legal Description: \_\_\_\_\_ Attachment   
 Add/Sub \_\_\_\_\_ Block \_\_\_\_\_ Lot \_\_\_\_\_  
 County \_\_\_\_\_ City/Town \_\_\_\_\_ Section \_\_\_\_\_ Township \_\_\_\_\_ Range \_\_\_\_\_

**PART 4 - TYPE OF TRANSFER** Please complete fully, more than one may apply.

**Transfer by Recorded Instrument**  
 Sale  Gift  Barter  Part of 1031 or 1033 exchange  Transfer is subject to a reserved life estate

**Transfer by Operation of Law**  
 Termination of joint tenancy by death  Termination of life estate by death  Court decree  Merger, consolidation, or other business entity reorganization

**PART 5 - EXCEPTIONS FROM PROVIDING SALES PRICE INFORMATION** Please complete fully, more than one may apply.

<input type="checkbox"/> Gift	<input type="checkbox"/> Transfer pursuant to court decree
<input type="checkbox"/> Transfer in contemplation of death without consideration	<input type="checkbox"/> Tax deed or sheriff's deed (TAXABLE)
<input type="checkbox"/> Transfer between husband/wife or parent/child for nominal consideration	<input type="checkbox"/> Foreclosure (include trustee transfer under trust indenture and deed in lieu of foreclosure) (TAXABLE)
<input type="checkbox"/> Transfer of property of the estate of a decedent	<input type="checkbox"/> Merger, consolidation or reorganization of business entity
<input type="checkbox"/> Transfer to governmental agency (TAXABLE?)	<input type="checkbox"/> Sale of producing Timber land (TAXABLE)
<input type="checkbox"/> Correction, modification, or supplement of previously recorded instrument, no additional consideration	<input type="checkbox"/> Land eligible for Agricultural Classification (15-7-201, MCA)
<input type="checkbox"/> Termination of joint tenancy by death	<input type="checkbox"/> Transfer to a revocable living trust
<input type="checkbox"/> Termination of life estate by death	<input type="checkbox"/> Purchaser and seller are identical parties
	<input type="checkbox"/> Other (specify type) _____

**PART 6 - SALE INFORMATION** Please complete fully, more than one may apply.

Actual Sale Price: \$ \_\_\_\_\_ Was an SID payoff included in the sale price?  Yes  No  
 Financing:  Cash  FHA  VA  Contract  Other Did the buyer assume a SID?  Yes  No  
 Terms:  New loan OR  Assumption of existing loan Amount of SID paid or assumed: \$ \_\_\_\_\_  
 Value of personal property included in sale \$ \_\_\_\_\_ Was a mobile home included in the sale?  Yes  No  
 Value of inventory included in sale \$ \_\_\_\_\_ Value of license(s) included in sale \$ \_\_\_\_\_ Value of Good Will included in sale \$ \_\_\_\_\_

**PART 7 - WATER RIGHT DISCLOSURE** (See page 2 for important information about this section)

Seller (Grantor) has water rights on record with DNRC and some or all transfer to Buyer  Seller (Grantor) does not have water rights on record with DNRC  Seller (Grantor) is exempt from this disclosure requirement  
 Seller (Grantor) signature \_\_\_\_\_

**PART 8 - PREPARER INFORMATION** Preparer's signature is required

Name/Title \_\_\_\_\_ (please print) Company Name \_\_\_\_\_  
 Mailing Address \_\_\_\_\_ Signature \_\_\_\_\_  
 City \_\_\_\_\_ ST \_\_\_\_\_ Zip \_\_\_\_\_ Daytime Phone \_\_\_\_\_

**Clerk and Recorder Use Only**

<b>Type of Instrument:</b>	<input type="checkbox"/> Trust Deed	<b>Recording Information:</b>
<input type="checkbox"/> Warranty	<input type="checkbox"/> Interest	Document # _____
<input type="checkbox"/> Quit Claim	<input type="checkbox"/> Notice of Purchaser's interest	Book _____ Page _____
<input type="checkbox"/> Grant	<input type="checkbox"/> Statement of Acknowledgment	Date _____
<input type="checkbox"/> Contract For Deed	<input type="checkbox"/> Termination of Joint Tenancy	
<input type="checkbox"/> Bargain & Sale Deed	<input type="checkbox"/> Tax Deed	
<input type="checkbox"/> Decree		
<input type="checkbox"/> _____		

# 2007 Real Estate Withholding Remittance Statement

# 593

**Withholding Agent (Payer/Sender) Check one:**  Escrow/Title Company  Accommodator/Intermediary  Buyer

Name	<input type="checkbox"/> FEIN <input type="checkbox"/> CA Corp. No.
Address (number and street, suite, room, or PMB no.)	SSN or ITIN
City, State, and ZIP Code	Daytime telephone no. (     )
Contact Person's Name and Title (please type or print)	

- 1 Month and year of transfer, exchange completion, exchange failure, or installment payment for attached Forms 593-B ..... 1     / 07
- 2 Number of Forms 593-B attached ..... 2
- 3 Total withholding due for attached Forms 593-B ..... 3 \$ \_\_\_\_\_
- 4 Interest on previous late payment(s) which were due in 2007 ..... 4 \$ \_\_\_\_\_
- 5 Total amount of this payment. Add line 3 and line 4 ..... 5 \$ \_\_\_\_\_

Attach a check or money order for the full amount payable to "Franchise Tax Board." Write the payer's federal employer identification number (FEIN), California corporation number, or social security number (SSN) or Individual Taxpayer Identification Number (ITIN), and "2007 Form 593" on the check or money order.

**Note:** Make all checks or money orders payable in U.S. dollars and drawn against a U.S. financial institution.

Mail payment, Form 593 and Forms 593-B to: **FRANCHISE TAX BOARD  
PO BOX 942867  
SACRAMENTO CA 94267-0651**

## General Information

California Revenue and Taxation Code Section 18662 requires the buyer or other transferee to withhold either 3 1/3% of the total sales price or the alternative withholding amount elected and certified by seller, unless the seller certifies an exemption on Form 593-C Real Estate Withholding Certificate.

### Purpose

Use this form to report and remit the total real estate withholding for the month and to pay any interest assessed on late withholding payments for 2007. This form is also a transmittal for Form 593-B, Real Estate Withholding Tax Statement.

**Note:** You have the option to send one payment and Form 593 with the related Forms 593-B for each escrow instead of sending one total payment for all escrows that closed during the month.

**Do not use Form 593** to pay interest on late payments related to escrows that closed prior to 2006. If the interest due is for sales that closed in 2006, use the 2006 Form 593. If the interest due is sales that closed in 2005, use the 2005 Form 593. If the interest due is sales that closed in 2004, use the 2004 Form 593. Use Form 592-A, Nonresident Withholding Remittance Statement for interest due for sales that closed before 2004.

### Common Errors

**Incomplete Forms** – To speed processing provide all information, including your tax identification number, requested on the form.

**Payments** – Do not include payments for more than one month with a single Form 593.

**Address** – Use the mailing address listed on this form.

**Correct Year/Form** – Use only this form for transactions in 2007. If the transaction closed in a different year, or the installment payment being reported was not made in 2007, go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) to get the form for the correct year.

### Who Must File

Any person who withheld on the sale or transfer of California real property during the calendar month must file Form 593 to report and remit the amount withheld. Generally, this will be the title company, escrow company, accommodator, or intermediary. Normally, the buyer will only complete this form when reporting the withholding on installment payments.

### When and Where to File

File Form 593 and Form 593-B, and pay the amount of tax withheld within 20 days following the end of the month in which the transaction occurred.

# 2007 Real Estate Withholding Tax Statement

## 593-B

Attach to Form 593, Real Estate Withholding Remittance Statement

**Copy A** FOR FRANCHISE TAX BOARD

**Part I Withholding Agent (Payer/Sender)** Check one:  Escrow/Title Company  Accommodator/Intermediary  Buyer

Name, Mailing Address, (number and street, PO Box, rural route, Apt. no., suite, room, or PMB no.), City, State, and ZIP Code	<input type="checkbox"/> FEIN <input type="checkbox"/> CA Corp. No
	SSN or ITIN

**Seller or Transferor (Complete one 593-B for each seller, unless husband and wife)**

Name, Mailing Address, (number and street, PO Box, rural route, Apt. no., suite, room, or PMB no.), City, State, and ZIP Code	SSN or ITIN
	Spouse's SSN or ITIN (if jointly owned)
	<input type="checkbox"/> FEIN <input type="checkbox"/> CA Corp. No.

**Escrow or Exchange Information**

1 Escrow or Exchange Number	2 Date of Transfer, Exchange Completion, Exchange Failure, or Installment Payment	3 Total Sales Price \$	4 Ownership Percentage %
5 Address (or parcel number and county) of the California real property transferred	6 Withholding Method Selected Check one: <input type="checkbox"/> Total Sales Price (complete box 7a and 7b, skip box 8 and 9) <input type="checkbox"/> Alternative Election (skip box 7a and 7b, complete box 8 and/or 9)	7a Amount Subject to Withholding (Total Sales Price) \$ Check One: <input type="checkbox"/> Total Sales Price x Ownership % <input type="checkbox"/> Installment Sale Payment <input type="checkbox"/> Boot <input type="checkbox"/> Failed Exchange (Total Sales Price x Ownership %) <input type="checkbox"/> Failed Exchange (Less Boot at Sale)	
7b Amount Withheld From This Seller (Total Sales Price) \$ (.0333 x Amount subject to withholding from box 7a)	8 Amount Withheld From This Seller (Alternative Election) \$ Enter the amount from Form 593-E, line 17. Check One (see instructions): <input type="checkbox"/> 9.3% Individual <input type="checkbox"/> 8.84% Corporation <input type="checkbox"/> 10.84% Bank and Financial Corporation <input type="checkbox"/> 1.5% S Corporation <input type="checkbox"/> 3.5% Financial S Corporation	9 Installment Withholding Percent % (Percent from Box 9 instructions) <b>Apply this percent to all installment payments.</b>	

Preparer: Name and Title (please type or print)

Telephone Number

( )

**Part II Election and Certification of Seller or Transferor (Complete and Sign if you elect the Alternative Withholding Amount and you checked "Alternative Election" in box 6 and completed box 8 and/or 9.)**

Title and escrow persons and exchange accommodators are not authorized to provide legal or accounting advice for purposes of determining withholding amounts. Transferors are strongly encouraged to consult with a competent tax professional for this purpose.

Under penalties of perjury, I elect the alternative withholding and hereby certify that the information provided above is, to the best of my knowledge, true and correct. I understand that the Franchise Tax Board may review relevant escrow documents to ensure withholding compliance.

Seller's name (type or print) \_\_\_\_\_

Seller's signature \_\_\_\_\_ Date: \_\_\_\_\_

Spouse's name (if jointly owned) \_\_\_\_\_

Spouse's signature (if jointly owned) \_\_\_\_\_ Date: \_\_\_\_\_

CORRECTED (if checked)

FILER'S name, street address, city, state, ZIP code, and telephone no.		1 Date of closing	OMB No. 1545-0997 <b>2008</b> Form <b>1099-S</b>
		2 Gross proceeds \$	
FILER'S federal identification number	TRANSFEROR'S identification number	3 Address or legal description	
TRANSFEROR'S name			
Street address (including apt. no.)		4 Transferor received or will receive property or services as part of the consideration (if checked). . . . ▶ <input type="checkbox"/>	
City, state, and ZIP code			
Account or escrow number (see instructions)		5 Buyer's part of real estate tax \$	

**Proceeds From Real Estate Transactions**

**Copy B**

**For Transferor**

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported.

Form **1099-S**

(keep for your records)

Department of the Treasury - Internal Revenue Service