

**REVISED FINAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY
(4/25/08)**

Adopt the following regulations: 2558. *Distilled Spirits*, 2559. *Presumption – Distilled Spirits*, 2559.1. *Rebuttable Presumption – Distilled Spirits*, 2559.3. *Internet List* and 2559.5. *Correct Classification*.

This Revised Final Statement of Reasons Non-Controlling Summary (4/25/08) supersedes and replaces the Final Statement of Reasons Non-Controlling Summary and the Addendum to Final Statement of Reasons Non-Controlling Summary from OAL File No. 2007-1210-03 S. For the sake of completeness, these superseded documents are also included in the rulemaking record at tab 1, OAL File No. 07-1210-03S.

Introduction

In a letter dated October 25, 2006, the Board of Equalization (Board) received a petition for rulemaking requesting the Board adopt a regulation to tax flavored malt beverages (FMB) as distilled spirits and/or amend Alcoholic Beverage Regulation 2530. In December 2006, the Board voted to initiate the rulemaking process with respect to the taxation and classification of FMB. The Board's action began an Interested Parties process wherein the Board held Interested Parties meetings on February 22, 2007, and June 6, 2007, to identify and discuss issues relating to the classification and taxation of FMB. Board staff prepared several Issue Papers with draft regulatory language and received approximately 100 written submissions. The Interested Parties process concluded with the Board voting on August 14, 2007, to authorize publication of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 (hereafter, collectively, Regulations). A public hearing was held on November 15, 2007. Following the public hearing, the Board approved the Regulations.

The Regulations were subsequently filed with the Office of Administrative Law (OAL) on December 10, 2007. Later, in order to make changes recommended by OAL, the file was withdrawn on January 24, 2008. On March 19, 2008, the Board approved for publication revised language to the Regulations and directed that Formal Issue Paper No. 07-007 and its exhibits, be identified as a document relied upon and made available to the public for 15 days. Following the 15-day comment period, the Board adopted the revised Regulations on April 8, 2008. Unless otherwise indicated, all future references to the Regulations herein are to the revised Regulations adopted on April 8, 2008.

The adopted Regulations address that the definitions of "beer" and "distilled spirits" require clarity with respect to the classification for tax purposes of certain alcoholic beverages commonly referred to as flavored malt beverages or FMB. Neither California law, nor federal law, has a specific definition of FMB. According to the federal Alcohol and Tobacco Tax and Trade Bureau:

"Flavored malt beverages are brewery products that differ from traditional malt beverages such as beer, ale, lager, porter, stout, or malt liquor in several respects. Flavored malt beverages exhibit little or no traditional beer or malt beverage character. Their flavor is derived primarily from added flavors rather than from malt and other materials used in fermentation. At the same time, flavored malt beverages are marketed in traditional beer-type bottles and cans and distributed to the alcohol beverage market through beer and malt beverage wholesalers, and their alcohol content is similar to other malt beverages - in the 4-6% alcohol by volume range.

“Although flavored malt beverages are produced at breweries, their method of production differs significantly from the production of other malt beverages and beer. In producing flavored malt beverages, brewers brew a fermented base of beer from malt and other brewing materials. Brewers then treat this base using a variety of processes in order to remove malt beverage character from the base. For example, they remove the color, bitterness, and taste generally associated with beer, ale, porter, stout, and other malt beverages. This leaves a base product to which brewers add various flavors, which typically contain distilled spirits, to achieve the desired taste profile and alcohol level.

“While the alcohol content of flavored malt beverages is similar to that of most traditional malt beverages, the alcohol in many of them is derived primarily from the distilled spirits component of the added flavors rather than from fermentation.” (See 27 C.F.R. §§ 7 & 25 (2005).)

Under California law, FMB do not neatly fit into either the statutory definition of “distilled spirits” (Bus. & Prof. Code, § 23005) or the statutory definition of “beer” (Bus. & Prof. Code, § 23006):¹

23005. “Distilled spirits” means an alcoholic beverage obtained by distillation of fermented agricultural products, and includes alcohol for beverage use, spirits of wine, whiskey, rum, brandy, and gin, including all dilutions and mixtures thereof.

23006. “Beer” means any alcoholic beverage obtained by the fermentation of any infusion or decoction of barley, malt, hops, or any other similar product, or any combination thereof in water, and includes ale, porter, brown, stout, lager beer, small beer, and strong beer but does not include sake, known as Japanese rice wine.

For example, the final six words of the statutory definition of “distilled spirits” (i.e., “including all dilutions and mixtures thereof”) could be read to establish that FMB are “distilled spirits.” (See Bus. & Prof. Code, § 23005.) Under this reading of the statute whenever alcohol obtained from the distillation of fermented agricultural products is mixed, for beverage use, into an alcoholic beverage, the resulting beverage would, by definition, be a “distilled spirit” under California law. However, “beer” is defined by statute as “any alcoholic beverage obtained by fermentation of any infusion or decoction of barley, malt, hops, or any other similar product, or any combination thereof in water” (emphasis added). (See Bus. & Prof. Code, § 23006.) Accordingly, assuming that FMB retain enough alcohol from the initial fermentation process to cause them, on that basis alone, to qualify as alcoholic beverages (see Bus. & Prof. Code, § 23004), then it could also be reasonably argued that FMB fit California’s statutory definition of “beer” because they are alcoholic beverages obtained by the requisite fermentation. Therefore, because FMB could potentially meet the statutory definition of either “beer” or “distilled spirits,” interpretive action by the Board is required to resolve ambiguity for taxpayers subject to the Alcoholic Beverage Tax Law.

The ambiguity is problematic because under current law, sections 32151, 32201, 32220 of the Alcoholic Beverage Tax Law impose the following different taxes and surcharges on the sale of “beer” and “distilled spirits”:

¹ Revenue and Taxation Code section 32002 provides that the definitions set forth in the Alcoholic Beverage Control Act (Bus. & Prof. Code, § 23000 et seq.) govern the Alcoholic Beverage Tax Law. (Rev. & Tax. Code, § 32001 et seq.)

	Per Gallon Tax	Per Gallon Surcharge	Total
Beer	\$0.04	\$0.16	\$0.20
Distilled spirits (\leq 100 proof)	\$2.00	\$1.30	\$3.30
Distilled spirits (100+ proof)	\$4.00	\$2.60	\$6.60

Without clarification regarding which alcoholic beverages are “beer” and which are “distilled spirits,” taxpayers may report and pay incorrect amounts.

Prior to 1955, the Board was responsible for all aspects of the regulation, licensing and taxation of the manufacture and sale of alcoholic beverages in California. Commencing on January 1, 1955, and pursuant to a constitutional amendment (Cal. Const., art. XX, § 22), the California Department of Alcoholic Beverage Control (ABC) was given “the exclusive power, *except as herein provided* and in accordance with laws enacted by the Legislature, to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes on account thereof.” (*Id.* [emphasis added].) Specifically, the constitutional amendment at issue carves out certain powers from the ABC and confers them on the Board as follows: “The State Board of Equalization *shall assess and collect such excise taxes as are or may be imposed by the Legislature* on account of the manufacture, importation, and sale of alcoholic beverages in this state.” (*Id.* [emphasis added].) In addition, Business and Professions Code section 23051 states in part:

On and after January 1, 1955, the department [ABC] shall succeed to all of the powers, duties, purposes, responsibilities, and jurisdiction now conferred on the State Board of Equalization under Section 22 or Article XX of the Constitution and this division, *except the power to assess and collect such excise taxes as are or may be imposed by law* on account of the manufacture, importation, and sale of alcoholic beverages in this State, which shall remain the exclusive power of the State Board of Equalization. All other laws heretofore or hereafter applicable to the State Board of Equalization with respect to alcoholic beverages, except as to excise taxes, shall hereafter be construed to apply to the department. (Emphasis added.)

As a result of this, while the ABC is assigned, among other things, the responsibility for the licensing of retail locations that sell alcoholic beverages in California, the Board is exclusively responsible for assessing (inclusive of the power to classify alcoholic beverages for purposes of such assessment) and collecting tax on account of the manufacture, importation, and sale of alcoholic beverages in California. Therefore, this rulemaking process pertains only to the classification of FMB for tax purposes under the Alcoholic Beverage Tax Law.

Accordingly, pursuant to its authority to promulgate regulations under the Alcoholic Beverage Tax Law (Rev. & Tax Code, § 32451), the Board has adopted the following new Regulations in order to clarify for the purpose of taxation when an alcoholic beverage meets the definition of a “distilled spirits” or a “beer.”

Specific Purpose/Necessity

Based on and inclusive of the foregoing, the specific purpose of each adoption, and the rationale for the determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed, is as follows:

Regulation 2558. Distilled Spirits.

This regulation clarifies that distilled spirits include an alcoholic beverage, except wine as defined by Business and Professions Code section 23007, which contains 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. The purpose of this regulation is to provide a bright line for when an alcoholic beverage is a “distilled spirit” under the Alcoholic Beverage Tax Law. Clarity is necessary because certain alcoholic beverages like FMB could potentially fall under both the definition of “beer” and “distilled spirits.”

The Board determined the definition of “distilled spirits” required clarification because, unlike the definition of “beer,” the definition of “distilled spirits” utilizes statutory language that allows for “dilutions or mixtures.” The 0.5 percent threshold was selected for two reasons. First, a bright line was needed to assist taxpayers in properly reporting and paying taxes. Therefore, since California law uses a 0.5 percent threshold to establish what beverage products contain a sufficient percentage of alcohol by volume to qualify as alcoholic beverages (See Bus. & Prof. Code, § 23004), if an alcoholic beverage contains 0.5 percent or more alcohol by volume obtained from the distillation of fermented agricultural products (whether added via flavors or other ingredients containing such alcohol, or otherwise), then that alcoholic beverage should be classified as a distilled spirit for taxation purposes. This standard allows for a de minimis or negligible amount of alcohol from distillation to be allowed in products obtained from fermentation as a result of adding a diminutive amount of flavorings and thereby preserves the definition of “beer” since the use of small amounts of alcohol-based flavorings (e.g., hops extract) can occur even in the manufacture of traditional beer products; but, at the same time, this standard recognizes that alcoholic beverages with the requisite amounts of alcohol from distillation meet the definition of “distilled sprits.” Second, the federal Alcohol and Tobacco Tax and Trade Bureau, during its rulemaking process addressing FMB, considered a 0.5 percent threshold. (70 Fed. Reg. 194 et seq. (January 3, 2005).) During the federal rulemaking process traditional beer companies indicated that their products were generally under this threshold.

Wine, as defined by Business and Professions Code section 23007, was excluded from the regulation because the definition of “wine” (Bus. & Prof. Code, § 23007) specifically allows for the inclusion of certain distilled products, if the added products are “distilled from the particular agricultural product or products of which the wine is made,” together with no more than “15 percent added flavoring, coloring, and blending material,” so long as the finished product “contains not more than 24 percent of alcohol by volume”² Therefore, unlike the definition of “beer,” the statutory definition of “wine” specifically provides for certain mixtures or additions of alcohol obtained from distillation. Thus, in contrast to FMB, no similar clarification is required with respect to which products are within the definition of “wine.”

The October 1, 2008, effective date is necessary to provide interested parties affected by the regulation, and the Board, sufficient time to facilitate an efficient implementation of the new regulation.

This regulation is necessary to provide clear, objective guidance to taxpayers with respect to which alcoholic beverages meet the definition of “beer” and which ones meet the definition of “distilled spirits” under the Alcoholic Beverage Tax Law. Without clarification regarding which alcoholic beverages are “beer” and which are “distilled spirits,” taxpayers may report and pay incorrect amounts.

² “‘Wine’ means the product obtained from normal alcoholic fermentation of the juice of sound ripe grapes or other agricultural products . . . or any such alcoholic beverage to which is added grape brandy, fruit brandy, or spirits of wine, which is distilled from the particular agricultural product or products of which the wine is made . . . and which does not contain more than 15 percent added flavoring, coloring, and blending material and which contains not more than 24 percent of alcohol by volume” (Bus. & Prof. Code, § 23007 [emphasis added].)

Regulation 2559. Presumption – Distilled Spirits.

This regulation establishes a rebuttable presumption that alcoholic beverages, except wine as defined by Business and Professions Code section 23007, contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. If a manufacturer does not rebut the presumption as provided in Regulation 2559.1, the alcoholic beverage will be presumed to meet the definition of “distilled spirits.”

This regulation is necessary in order to assist the Board with classifying products that meet the 0.5 threshold provided in Regulation 2558. In the interest of administrative feasibility, this regulation rebuttably presumes that alcoholic beverages contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. The Board understands that there are potentially thousands of alcoholic beverages which may meet the clarifying standard set forth in Regulation 2558. Neither the Board nor the ABC possesses the necessary expertise to chemically analyze alcoholic beverages. Therefore, this presumption was utilized to place the burden of establishing which alcoholic beverages contain the requisite amount of alcohol from distillation on the parties with the actual knowledge of the contents of these beverages. This presumption also eliminates the undue delay and minimizes the administrative inefficiencies that would result from requiring the Board to analyze or review each alcoholic beverage sold in this state before tax could properly be assessed and collected.

The October 1, 2008, effective date is necessary to provide interested parties affected by the regulation, and the Board, sufficient time to facilitate an efficient implementation of the new regulation.

This regulation is necessary to provide clear, objective guidance to taxpayers with respect to which alcoholic beverages meet the definition of “beer” and which ones meet the definition of “distilled spirits” under the Alcoholic Beverage Tax Law. Without clarification regarding which alcoholic beverages are “beer” and which are “distilled spirits,” taxpayers may report and pay incorrect amounts.

Regulation 2559.1. Rebuttable Presumption – Distilled Spirits.

This regulation allows the manufacturer to rebut the presumption set forth in Regulation 2559 with respect to any alcoholic beverage by filing a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The regulation additionally provides that the Board shall require a copy of the manufacturer’s “Statement of Process” or “Formula” filed with the federal Alcohol and Tobacco Tax and Trade Bureau, its predecessor agency or successor agency only if the Board obtains information that casts doubt on the accuracy or truthfulness of a report filed or for purposes of verifying any report filed. Such a rebuttal and verification process is necessary to ensure that the correct amount of tax is being paid and collected.

This regulation recognizes that many products may contain less than 0.5 percent alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products and that a manufacturer must be allowed to rebut the presumption set forth in Regulation 2559, subject to verification by the Board. Additionally, the report under penalty of perjury mechanism for rebuttal was selected to ensure that only a minimal burden is placed on manufacturers seeking to rebut the presumption.

The regulation further provides a manufacturer a process to petition the Board if the manufacturer disputes a Board determination that the manufacturer has not successfully rebutted the presumption in Regulation 2559. The administrative appeals process provided is patterned after the Board's current process for tax appeals. This administrative appeals process is necessary to provide manufacturers with due process by ensuring that sufficient administrative remedies exist and may be exhausted.

Additionally, this regulation is necessary in order to provide the mechanism for a manufacturer, with minimum burden, to rebut the presumption that its alcoholic beverage is a distilled spirit and furthers the necessity of providing clear, objective guidance to taxpayers with respect to which alcoholic beverages meet the definition of "beer" and which ones meet the definition of "distilled spirits" under the Alcoholic Beverage Tax Law. Without clarification regarding which alcoholic beverages are "beer" and which are "distilled spirits," taxpayers may report and pay incorrect amounts.

Regulation 2559.3. Internet List.

This regulation requires the Board to establish and maintain on its Internet site a listing of alcoholic beverages that have been found to have successfully rebutted the presumption. An Internet list was selected because it is the most efficient way to provide taxpayers with the most current information for reporting and paying any tax amounts due under the Alcoholic Beverage Tax Law.

The regulation additionally provides that the Board shall require a manufacturer's "Statement of Process" and "Formula" filed with the Alcohol and Tobacco Tax and Trade Bureau, its predecessor agency or successor agency only if the Board obtains information that casts doubt on the accuracy or truthfulness of a report filed pursuant to Regulation 2559.1 or for purposes of verifying any such report filed. Such a verification process is necessary to allow the Board to ensure that the correct tax is being paid and collected.

The October 1, 2008, effective date is necessary to provide interested parties affected by the regulation, and the Board, sufficient time to facilitate an efficient implementation of the new regulation.

The regulation further provides a manufacturer a process to petition the Board before an alcoholic beverage is removed from the Internet list, in the event the Board determines that an alcoholic beverage posted on the list contains 0.5 percent or more alcohol by volume derived from flavors or other ingredients containing alcohol obtained from the distillation of fermented agricultural products (i.e., if the Board determines that an alcoholic beverage is posted on the Internet list in error). The administrative appeals process provided is patterned after the Board's current process for tax appeals. This administrative appeals process is necessary to provide manufacturers with due process by ensuring that sufficient administrative remedies exist and may be exhausted.

This regulation is necessary to assist taxpayers in classifying products as "beer" or "distilled spirits" for purposes of reporting and paying any taxes due under the Alcoholic Beverage Tax Law. Without clarification regarding which alcoholic beverages are "beer" and which are "distilled spirits," taxpayers may report and pay incorrect amounts.

Regulation 2559.5. Correct Classification.

This regulation provides that taxpayers who rely for reporting purposes on the information provided on the Internet list required by Regulation 2559.3 will be afforded a safe harbor from potential tax liabilities.

The October 1, 2008, effective date is necessary to provide interested parties affected by the regulation, and the Board, sufficient time to facilitate an efficient implementation of the new regulation.

This regulation is necessary because the Board recognizes that in many instances the taxpayer is not the manufacturer of the alcoholic beverage in question, and, therefore, the taxpayer should be able to rely on the Board's Internet list when reporting and paying taxes under the Alcoholic Beverage Tax Law. This ability to rely on the Board's Internet list furthers the necessity of providing clear, objective guidance to taxpayers with respect to which alcoholic beverages meet the definition of "beer" and which ones meet the definition of "distilled spirits" under the Alcoholic Beverage Tax Law. Without clarification regarding which alcoholic beverages are "beer" and which are "distilled spirits," taxpayers may report and pay incorrect amounts.

No Other More Effective Alternative

The following two alternatives were considered:

1. The first alternative, proposed by interested parties in the Board's Interested Parties process, proposed to amend current Regulation 2500, *Records*. (Cal. Code Regs., tit. 18, § 2500.) The proposed alternative regulatory language, as written, appears to assume that any alcoholic beverage with any amount of alcohol derived from distillation processes would meet the definition of distilled spirits for tax purposes. The following is the language submitted (with the proposed amendment reflected by underlining):

Regulation 2500 – Records.

A taxpayer shall maintain and make available for examination on request by the board or its authorized representatives, records in the manner set forth at California Code of Regulations, Title 18, Section 4901. In addition to the records described therein, commencing July 1, 2004, a taxpayer that manufactures any alcoholic beverage shall annually submit a statement for each of the taxpayer's alcoholic beverage products indicating whether that beverage product contains alcohol produced through distillation, and if so, stating the percentage of such product's total alcohol content derived from distilled spirits. The taxpayer shall make this statement under penalty of perjury.

This alternative was not chosen because it appears to assume that any alcoholic beverage with any amount of alcohol derived from distillation processes would meet the definition of distilled spirits for tax purposes. Since the use of small amounts of alcohol-based flavorings (e.g., hops extract) can occur even in the manufacture of traditional beer products, this alternative would likely include many traditional beer products and could render the definition of "beer" (Bus. & Prof. Code, § 23006) obsolete. Additionally, this alternative does not provide a bright line for taxpayers to determine which alcoholic beverages meet the definition of "beer" or which ones meet the definition of "distilled spirits."

2. The second alternative proposed no regulatory change, which would result in continuing to tax FMB as “beer.” This alternative was not chosen because the Board determined that FMB containing substantial amounts of alcohol obtained by distillation of fermented agricultural products must be classified as “distilled spirits” under Business and Professions Code section 23005. The Board further determined that the most reasonable approach was to tax products, which are derived at least in part from a beer brewing manufacturing process, that had more than a de minimis amount of such distilled alcohol as “distilled spirits,” but those with less than a de minimis amount as “beer,” thereby preserving and clarifying the statutory definitions of both “beer” and “distilled spirits.” Therefore, the Board concluded that this second alternative would not provide the clarification needed regarding which alcoholic beverages meet the respective definitions of “beer” and “distilled spirits.” (See Bus. & Prof. Code, §§ 23005, 23006.)

Accordingly, the Board determined that no alternative would be more effective, or as effective and less burdensome, than the proposed Regulations.

No Economic Impact

The Board has determined, based on the following, that the Regulations will not have a significant adverse economic impact on private business or persons. The Board is mandated to administer and collect the taxes imposed by in the Legislature as set forth in the Alcoholic Beverage Tax Law. The Regulations are proposed to interpret, implement, and make specific the authorizing statutes. These Regulations will provide a bright line for determining which alcoholic beverages meet the statutory definition of “beer” and which ones meet the statutory definition of “distilled spirit” for purposes of the Alcoholic Beverage Tax Law. Any impact these statutes may have on private business or persons was studied and analyzed by the Legislature when it enacted the statutes. Further, the Regulations provide that manufacturers *may* rebut the presumption (i.e., they are not required to do so), and the Regulations set forth no additional cost or fee requirement. Any potential additional taxes owing are a cost of doing business, and are, in the Board’s experience, passed on to the ultimate consumer.

Report Requirement

Regulation 2559.1 allows a manufacturer to file a report to rebut the presumption set forth in Regulation 2559. Government Code section 11346.3(c) provides that “[n]o administrative regulation adopted on or after January 1, 1993, that requires a report shall apply to businesses, unless the state agency adopting the regulation makes a finding that it is necessary for the health, safety, or welfare of the people of the state that the regulation apply to businesses.” While the report referenced in the Regulations may not be the type of report contemplated by section 11346.3(c), the Board finds that the report referenced is necessary for the health, safety, or welfare of the people of the state in that the Regulations clarify when certain taxes apply. The Board is constitutionally required to assess and collect these taxes and the taxes collected are deposited into the State’s General Fund, for expenditures for the health, safety, or welfare of the people of the state. Without the proper assessment and collection of taxes, the deposits in the General Fund may be reduced, thereby affecting the health, safety and welfare of the people of the state.

No Federal Mandate / Comparable Regulations

The Regulations are not mandated by federal law and, while the Regulations are comparable to Federal Regulation 27 CFR § 25.15, the Regulations provide a presumption for when a product is a distilled spirits under California law. The presumption specifically applies to alcoholic beverages, except wine

as defined by Business and Professions Code section 23007, that contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. In contrast, the federal regulation provides that malt beverages (e.g., beer) that contain less than 6 percent alcohol by volume may derive no more than 49 percent of their alcoholic content from flavors and other non-beverage materials.

Local Mandate Determination

The Board has determined that the adopted Regulations do not impose a mandate on local agencies or school districts. Further, the Board has determined that the adopted Regulations will not result in direct or indirect costs or savings to any state agency, or in any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code, or in other non-discriminatory costs or savings imposed on local agencies, or in costs or savings in federal funding to the State of California.

Responses to Public Comment

The Board received the following written and oral comments on the proposed Regulations. The written comments, except as noted below, were received during the 45-day comment period and subsequent 15-day comment period. The oral comments were received at the November 15, 2007, Board meeting where the required public hearing was held. Following the 15-day notice period, at the April 8, 2008, Board meeting, the Board adopted the proposed Regulations as published.

45-day Written Comments

Received during the 45-day comment period:

Comment 1: Shawn Weymouth

In an e-mail message dated November 14, 2007, Shawn Weymouth wrote “[t]hank you for your August vote and I ask you to stand your ground tomorrow.”

Response

The Board hereby acknowledges the written comment. The Board made no changes to the Regulations as a result of this comment.

Comment 2: Vanessa S. Bedford, Deputy Legislative Counsel, Legislative Counsel of California

In a letter dated October 25, 2007, to the Honorable Greg Aghazarian, forwarded to the Board by the Honorable Bill Leonard, Member, Board of Equalization, Ms. Bedford responds to the following request made by the Honorable Greg Aghazarian:

“You have asked whether the State Board of Equalization has the authority to interpret the terms ‘distilled spirits,’ ‘beer,’ and ‘wine’ for purposes of the Alcoholic Beverage Tax Law (Pt. 14 (commencing with Sec. 32001), Div. 2, R.&T.C.).”

Ms. Bedford concludes the following:

“In conclusion, in light of the foregoing, the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law (Pt. 14 (commencing with Sec. 32001), Div. 2, R.&T.C.), interpret the terms ‘distilled spirits,’ ‘beer,’ and ‘wine’ only in a manner consistent with the definition of those terms as set forth in statute, as validly interpreted by the Department of Alcoholic Beverage Control. The State Board of Equalization may not, however, interpret the terms ‘distilled spirits,’ ‘beer,’ and ‘wine’ in a manner that is inconsistent with the Department of Alcoholic Beverage Control’s valid interpretation of those statutes.”

Response

To the extent Ms. Bedford’s analysis and conclusions suggest that the Board does not have the exclusive power to classify alcoholic beverages for purposes of assessing and collecting tax under the Alcoholic Beverage Tax Law, the Board respectfully disagrees. (See Bus. & Prof. Code, § 23051.) However, it should be noted that, even if Ms. Bedford’s analysis and conclusions were correct, which to the extent they suggest a limitation of the Board’s exclusive assessment power they are not, the subject Regulations adopted by the Board do not, as a practical matter, run afoul of Ms. Bedford’s analysis and conclusions. Thus, regardless of the validity of Ms. Bedford’s comments, the Regulations adopted by the Board required no change because they interpret the terms “distilled spirits” and “beer” for purposes of the Alcoholic Beverage Tax Law in a manner consistent with the definition of those terms as set forth in the applicable statutes. Further, the Regulations adopted are not inconsistent with any valid interpretation of those statutes by ABC, as evidenced by the fact that ABC has no duly promulgated regulations that interpret the terms “distilled spirits” or “beer,” as those terms relate to the classification of FMB or otherwise. Accordingly, the proposed Regulations are not inconsistent with any valid interpretation of the applicable statutes by ABC.

Comment 3: Marc E. Sorini, Esq., Mc Dermott Will & Emory, on behalf of the Flavored Malt Beverage Coalition (Coalition)

In a letter dated November 8, 2007, written on behalf of the Coalition to the Members of the State Board of Equalization, Mr. Sorini wrote in opposition to the proposed Regulations. In summary, Mr. Sorini set forth the following comments:

- A. The proposed regulations are inconsistent with governing law and therefore beyond the Board’s authority. Within this comment, Mr. Sorini argues that “Flavors Are Not Distilled Spirits,” “FMBs Contain Flavors, Not Distilled Spirits,” and “FMBs Are Beer.”

Response

The Regulations are consistent with the governing law in that the Regulations clarify when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.” On that basis and as further discussed below, no changes were made to the regulatory language.

As set forth previously and contrary to the Coalition’s assertions in its comments that FMB are not “distilled spirits,” but “beer,” because they contain flavors, not “distilled spirits,” the Board has determined that FMB do not neatly fit into either the statutory definition of “distilled spirits” (Bus. & Prof. Code, § 23005) or the statutory definition of “beer” (Bus. & Prof. Code, § 23006). This determination is supported most pointedly by ABC’s comments dated November 14, 2007, (set forth and discussed in 45-day Written Comment 7, below) which support the fact

that the definitions are out of date, ambiguous and potentially subject to multiple and contradictory interpretations. Therefore, the Board has determined, contrary to Mr. Sorini's comment, that FMB do not neatly fit into either category and that interpretive action by the Board is required to resolve the ambiguity so that tax will be properly assessed and collected under the Alcoholic Beverage Tax Law.

Therefore, the Board has adopted the subject Regulations to clarify that "distilled spirits" include an alcoholic beverage, except "wine" as defined by Business and Professions Code section 23007, which contains 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products.

- B. The Board's presumption that all non-wine alcohol beverages are distilled spirits is inconsistent with governing law and beyond the Board's authority.

Response

Contrary to this comment, Regulation 2559, *Presumption – Distilled Spirits*, is consistent with governing law. The final six words of the statutory definition of "distilled spirits" (i.e., "including all dilutions and mixtures thereof") can be read to establish that any alcoholic beverages containing distilled spirits fall within the definition of distilled spirits (Bus. & Prof. Code, § 23005). Since an alcoholic beverage containing any amount of distilled spirits could fall within the definition of distilled spirits, the 0.5 percent threshold set forth in Regulation 2558, which identifies those products that contain a substantial amount of distilled spirits, is consistent with governing law.

The presumption is utilized in order to assist the Board with classifying products that meet the 0.5 threshold provided in Regulation 2558 and was chosen in the interest of administrative feasibility. In order to ensure that products that do not reach the 0.5 threshold can be removed from the operation of the presumption, Regulation 2559.1 provides the ability for manufacturers to rebut the presumption. Accordingly, no change was made to the regulatory language adopted by the Board.

- C. The Board, a tax collection body, lacks the authority to adopt the proposed regulations because they are not consistent with the policies of the Department of Alcoholic Beverage Control.

Response

The regulatory action was adopted based on the Board's authority pursuant to Revenue and Taxation Code section 32451 to adopt regulations for purposes of the Alcoholic Beverage Tax Law. These Regulations are required to clarify when an alcoholic beverage meets the definition of a "distilled spirit" or a "beer" for tax purposes and are not inconsistent with any regulation promulgated by ABC.

Additionally, the Legislative Counsel of California has opined (see 45-day Written Comment 2, above) that the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law, interpret the terms "distilled spirits," "beer," and "wine" as long as it is consistent with those terms as set forth in statute and as validly interpreted by ABC. The Board's adoption of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 is consistent with the statutory language and is not contrary to any regulation promulgated by ABC.

Finally, notwithstanding the Legislative Counsel opinion, the Board has the exclusive power to promulgate rules related to classification for purposes of tax assessment and collection. (Rev. & Tax. Code, § 32451.) Accordingly, no change was made to the regulatory language adopted by the Board.

- D. The proposed regulations are inconsistent with California law that compels the Board to follow federal law concerning the “system of beer and wine taxation” imposed by the federal government.

Response

Revenue and Taxation Code section 32152 provides that “the board [Board of Equalization] shall adopt such rules and regulations as may be necessary to coordinate so far as permitted by the provisions of this part [the California Alcoholic Beverage Tax Law] the system of beer and wine taxation imposed by this part with the system of beer and wine taxation imposed by the internal revenue laws of the United States.” Relevant to this issue, this section only applies to products that have been classified for purposes of tax assessment as either beer or wine. However, the Regulations adopted by the Board create a regulatory system to clarify what is classified as a “beer” and what is classified as “distilled spirits.” To the extent FMB would be classified as “distilled spirits” under these Regulations, Revenue and Taxation Code section 32152 would not apply to the taxation of FMB.

Additionally, even if, for argument’s sake, Revenue and Taxation Code section 32152 applied, the statute does not provide that the Board must follow exactly federal law. The statute provides only for “coordination,” when appropriate. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- E. The proposed regulations are inconsistent with federal and state law because the exemption of wine with flavors would violate the federal Constitution’s Commerce Clause and the Equal Protection guarantees of the federal and state constitutions.

Response

With respect to the Commerce Clause, the law currently taxes beer, wine and distilled spirits differently and there is no burden on interstate commerce that in any way gives rise to a Commerce Clause violation. Therefore, the addition of Regulations to clarify existing statutory classifications of “beer” and “distilled spirits” for tax purposes under the current definitions would not now cause a violation of the Commerce Clause. (See *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274). Interstate and intrastate transactions involving beer, wine and distilled spirits would all be treated the same under the Regulations, within the parameters of each product’s statutory definition. If an alcoholic beverage does not meet the definition of “wine” because, for example, distilled alcohol is added in a manner inconsistent with the requirements of Business and Professions Code section 23007, then the alcoholic beverage would be subject to the same presumption as FMB.

With respect to the Equal Protection argument, the classification distinction would survive the required rational relationship test. (See, e.g., *Fitzgerald v. Racing Association of Iowa* (2003) 539 U.S. 103). The Legislature has differentiated between beer, wine and distilled spirits in statutory definitions and provided different tax rates for each. There are certainly rational

reasons for the differing definitions and tax rates. Further clarification of the definitions of “beer” and “distilled spirits” for effective tax classification under existing statutes for purposes of addressing a product that does not fit neatly into either category would not fail the rational relationship test.

Accordingly, no change was made to the regulatory language adopted by the Board.

F. The proposed regulations are inconsistent with beverage labeling law.

Response

How a product is labeled is not impacted by the adopted Regulations. The regulations are adopted *solely* for purposes of taxation under the Alcoholic Beverage Tax Law. Accordingly, no change was made to the regulatory language adopted by the Board.

G. The proposed regulations expose beer manufacturers and wholesalers to significant risks of disclosure of trade secrets concerning product formulation.

Response

As Mr. Sorini acknowledges in his comment, the Alcoholic Beverage Tax Law does not contain provisions prohibiting disclosure of taxpayer information similar to other tax programs administered by the Board. Section 32455 provides the following:

“It is unlawful for the board or any person having an administrative position under this part to make known in any manner whatever any information set forth or disclosed in any report from any winegrower pursuant to this part regarding the names of the purchasers and the amounts of individual sales of wines which the winegrower has exported from this state, or to permit the portion of any report or copy thereof which contains such information to be seen or examined by any person. This section does not prohibit the publication by the board of any winegrower’s total receipts from the export of wines from this state.

Nothing in this section shall prevent the board from exchanging with officials of other states information concerning the interstate shipments of wine.”

Therefore, other than disclosure affecting winegrowers, there is no specific statutory authority to add regulatory language. The Legislature has provided a specific disclosure statute. (Rev. & Tax. Code, § 32455.) The Board recognizes and fully appreciates the seriousness of confidentiality as it relates to any proprietary information the Board may receive as authorized by the Regulations.

The Board will not produce any information protected by any other statutory privilege. For example, trade secret information is protected information. (See Gov. Code, § 6254, subd. (k); Evid. Code, § 1060).

The Public Records Act (PRA) (Gov. Code, § 6250 et seq.) requires the Board to provide public access to any records the Board maintains, unless the records are legally exempt from disclosure. Any person can file a PRA request. The Board is nonetheless prohibited from

disclosing any information it obtains concerning the business affairs of a company under Government Code section 15619.

Government Code section 15619 provides, in pertinent part, that:

“Any member or ex-member of the State Board of Equalization, or any agent employed by it, or the Controller, or ex-Controller, or any person employed by him or her, or any person who has at any time obtained such knowledge from any of the foregoing officers or person shall not divulge or make known in any manner not provided by law, any of the following items of information concerning the business affairs of companies reporting to the board:

[¶] . . . [¶]

“(b) Any information, other than the assessment and the amount of taxes levied, obtained by the State Board of Equalization in accordance with law from any company other than one concerning which that information is required by law to be made public.”

Pursuant to this section, in response to a PRA request or otherwise, Board staff would not, absent a final court order, disclose any confidential information obtained pursuant to requirements of the adopted Regulations.

Trade secrets are protected by Evidence Code section 1060, which has been incorporated as an exception from disclosure of records in the PRA. (Gov. Code, § 6254, subd. (k).) However, before withholding documents from a PRA request on the basis of “trade secrets,” the Board has the obligation to initially determine if the records are “trade secrets.” The term “trade secrets” is defined in the Uniform Trade Secrets Act. (Civ. Code, § 3426 et seq.)

Specifically, Civil Code section 3426.1, subdivision (d), provides that:

“Trade secrets means information, including a formula, pattern, compilation, program, device, method, technique, or process, that:

1. Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
2. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”

The information involving the formulas of the alcoholic beverages in question would meet this definition. Therefore, in the event the Board were to receive such information for purposes of establishing the proper tax classification of these beverages, the Board would not disclose this information and would vigorously defend against any attempt to compel disclosure through litigation or otherwise. Additionally, the Board would give notice to the person whose information was being sought by any PRA request asking for the disclosure of confidential information.

Further, to ensure that confidential taxpayer information would not need to be disclosed during the course of the administrative appeals process, Regulation 2559.5, *Correct Classification*,

was adopted to protect taxpayers who are not the manufacturers of the products subject to the presumption set forth in Regulation 2559. Regulation 2559.5 provides that a taxpayer be deemed to have correctly classified an alcoholic beverage for purposes of reporting if, at the time taxes are imposed, the alcoholic beverage was included in the Board's list published on its Internet site pursuant to Regulation 2559.3. This "safe harbor" would be an absolute defense for the taxpayer and would mean that information about product formulas or manufacturing processes would not be required at a public Board meeting.

If, however, it became necessary for the Board to review documentation pertaining to the exact sources and amount of alcohol in a disputed product, which is a circumstance the Board believes would rarely arise since the presumption of Regulation 2559 sets forth an objective bright line and it is unlikely that manufacturers would willingly perjure themselves when filing reports under Regulation 2559.1, the Board has the ability under its Rules for Tax Appeals to conduct hearings, or portions of hearings, involving confidential information in a closed session (See Gov. Code, § 11126, subd. (f)(7)(B) & (f)(8); see also Cal. Code Regs., tit. 18, § 5574 [Rules for Tax Appeals 5574].)

The Board cannot anticipate, however, the particular requests for information the Board may receive in the future as a result of the adopted Regulations. Any decision on disclosure would be considered individually. Therefore, a rule of general application would not be appropriate. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- H. The proposed regulations are invalid because the Board fails to demonstrate that they will not have an adverse impact on California businesses.

Response

The Board has determined that the Regulations will not have a significant adverse economic impact on private business or persons. The Regulations interpret, implement, and make specific the authorizing statutes. In other words, the Regulations clarify existing statutes. These Regulations provide a bright line for determining which alcoholic beverages meet the definition of "beer" and which ones meet the definition of "distilled spirit" for purposes of the Alcoholic Beverage Tax Law. As such, they affect only the tax rate at which taxpayers pay taxes currently levied.

The Board does not agree with Mr. Sorini that there will be an adverse impact on California businesses. Board staff prepared a Revenue Estimate that provides an excise tax revenue increase of \$38.3 million per year. This estimate contains qualifying remarks acknowledging that there are several assumptions that were made given uncertainties in the market that cannot be determined with certainty. In any case, affected California businesses will be able to recoup the economic cost of correctly classifying FMB that were previously erroneously assessed as "beer" by passing this cost on to their customers. While the passing on of this cost may have some effect on which products retail customers of legal age may purchase, Mr. Sorini has provided no persuasive evidence that the subject Regulations will have a significant adverse impact on California businesses. For example, customers may purchase other alcoholic beverage products or manufacturers may provide incentives for purchasing FMB that offset any costs associated with correctly classifying FMB as distilled spirits. Moreover, many consumers may continue to buy FMB, even at a higher price, if any. Further, as Mr. Sorini's report suggests, manufacturers may reformulate FMB so that their products will clearly fall under the

“beer” classification. There is no certainty and there is no requirement that the manufacturers reformulate. While a report prepared by the Economic Consulting Services (ECS Report) submitted by the Coalition claims economic suffering by its members. It is not persuasive evidence since many of the factors considered by the report cannot be determined with certainty. For example, while the Coalition members surveyed for the ECS Report all state they will reformulate, the members are arguably not impartial.

In short, the Board does not agree that any significant adverse impact on California businesses would be caused by the clarification of existing statutory definitions. The Board, with these Regulations, is not changing the tax law, but instead providing needed clarification for what products meet the existing statutory definitions. Any impact these statutory definitions may have on business was studied and analyzed by the Legislature when it enacted the statutes. Further the Regulations provide that manufacturers *may* rebut the presumption of a product being a distilled spirit (i.e., they are not required to do so), and the Regulations set forth no new cost or fee requirement. Any potential additional taxes owing are a cost of doing business, and are, in the Board’s experience, passed on to the ultimate consumer.

Additionally, ABC is not required to follow these Regulations for purposes of licensing, so a licensee will not be required to obtain any different license to sell FMB. As a result, the burdens on industry associated with reporting sales of alcoholic beverages will not change. The procedures for rebutting the presumption that any non-wine alcoholic beverage be taxed as a distilled spirit are designed to impose only a minimal burden. Finally, according to the ECS Report submitted by the Coalition and referenced by Mr. Sorini, the FMB portion of California’s so-called “beer market” by volume was 2.4 percent in 2004 and 2.1 percent in 2006. Given the small size of this market segment, and in light of all the mitigating factors discussed above, correctly classifying FMB for tax purposes would not appear to have a significant impact on California businesses.

Accordingly, in the absence of any persuasive evidence of significant adverse impact on California businesses, no changes were made to the Regulations adopted by the Board.

- I. Mr. Sorini enclosed the following documents and requested that they be included in the rulemaking file:
 - a. A copy of the petition for rulemaking that began these proceedings.
 - b. Transcripts of the Board’s proceedings on December 12 and 13, 2006, February 22, 2007, and June 6, 2007.
 - c. The Initial Discussion Paper, dated February 9, 2007, and Second Discussion Paper, dated May 18, 2007, prepared by the Board staff for meetings with Interested Parties.
 - d. Copies of the Coalition’s prior submissions to the Board, with exhibits, dated December 7, 2006, February 19, 2007, March 15, 2007, May 10, 2007, and June 20, 2007.
 - e. Copies of the submissions made by other interested parties that the Board made available to the public during the course of the informal proceedings prior to the initiation of the 45-day comment period associated with formal rulemaking.

Response

The documents are included as part of the rulemaking record.

- J. Mr. Sorini, on page 2 of his letter, comments that the Board has relied on an August 3, 2007, Issue Paper and Revenue Estimate.

Response

In order to assure that all requirements of the Administrative Procedures Act have been followed in this rulemaking process, and since the Issue Paper was an item provided for the Board hearing where the Board initially voted to adopt the Regulations, the Board has added to the rulemaking file, as a document relied upon pursuant to Government Code sections 11346.8(d), 11346.9(a)(1), and 11347.1, Formal Issue Paper 07-007 (FIP), and Exhibits 1 through 4 attached thereto, dated August 3, 2007. The Revenue Estimate mentioned by Mr. Sorini is Exhibit 2 to the FIP.

- K. Mr. Sorini comments that “[t]he line between a distilled spirit and a nonbeverage flavor is drawn by an objective test that examines whether or not the product, standing on its own, is ‘unfit for beverage use’” and “the mere fact that such an ‘unfit’ product is later used in a beverage does not transform it into a distilled spirit.” He cites to the federal Alcohol and Tobacco Tax and Trade Bureau’s (TTB) determinations regarding every flavor on the market and asserts that “[p]roduct deemed ‘fit’ are taxed and regulated as beverage distilled spirits, both by the federal government and California.”

Response

The Board does not disagree that TTB has made specific determinations regarding flavors and that both the federal government and California regulate and tax distilled spirits. However, contrary to Mr. Sorini’s comment, the definition of a “distilled spirit” can also be read to include a FMB. The final six words of the statutory definition of “distilled spirits” (i.e., “including all dilutions and mixtures thereof”) can be read to establish that FMB are “distilled spirits.” (See Bus. & Prof. Code, § 23005.) Under this reading of the statute, whenever alcohol obtained from the distillation of fermented agricultural products is mixed, for beverage use, into an alcoholic beverage, the resulting beverage would be a “distilled spirit” under the statutory definition. Therefore, the Board has determined that interpretive action by the Board is required to resolve ambiguity for taxpayers subject to the Alcoholic Beverage Tax Law. Accordingly, no changes were made to the Regulations.

- L. In footnote 6 of his letter, Mr. Sorini states that he believes it is “astounding” that the Board stated in its Notice that the current regulations are “comparable to Federal Regulation 27 CFR § 2515.”

Response

The Notice does provide that the proposed Regulations are comparable to Federal Regulation 27 CFR § 25.15 and this Revised Final Statement of Reasons Non-Controlling Summary provides that the Regulations are not mandated by federal law, but are comparable to federal regulations. The word “comparable” has a dictionary meaning of “capable of being compared.” The proposed Regulations and the federal regulation cited are certainly capable of being compared since they both address alcoholic beverages commonly referred to as FMB.

However, as set forth above at page 8, the federal regulation and the proposed Regulations treat FMB differently. No changes were made to the Regulations based on this comment.

- M. Mr. Sorini asserts that the Board has admitted it lacks funds, staff, and computer processing and software development resources to implement the adopted regulations. He has set forth certain statements made by Ms. Lynn Bartolo, Chief of the Board's Excise Taxes Division, in support of his assertion.

Response

When the Regulations become effective, the Board and its staff will administer them. Board staff has begun assessing and planning for the staff and other resources needed for the Board to be prepared for the effective date. There is no statutory requirement that requires staffing and/or funding issues to be addressed in the Board's Hearing Notice and Initial Statement of Reasons. The Board is required to administer the Alcoholic Beverage Tax Law, which includes any and all regulations promulgated thereunder. If these Regulations are approved, the Board will effectively administer them under the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- N. In footnote 9, Mr. Sorini states that "these regulations, which would impose distilled spirits taxation on beer beverages without facts demonstrating that the beer beverages contain distilled spirits"

Response

The Board has determined that the definition of distilled spirits (Bus. & Prof. Code, § 23005) could be read to include alcoholic beverages that contain any amount of alcohol from the distillation of fermented agricultural products. Therefore, further clarification is required to determine when a product meets the definition of a distilled spirits for purposes of taxation. Contrary to this comment, the rulemaking file contains facts that demonstrate that alcoholic beverages exist, which are derived at least in part from a beer brewing manufacturing process, that may have been erroneously classified as beer products for California tax purposes because they may contain alcohol from the distillation of fermented agricultural products. (See, e.g. Initial Statement of Reasons, at p. 1 [quoting information from the federal Alcohol and Tobacco Tax Trade Bureau].) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- O. In footnote 10, Mr. Sorini states that "[t]he proposed regulations also expose wholesalers to unfair compliance risks since, typically, beer wholesalers, and not manufacturers, pay the California beer excise tax" because, he comments, manufacturers will not share formula information and wholesalers will bear the tax risks.

Response

The Board does not have control over manufacturers' business decisions. Regulation 2559.5 provides a safe harbor for taxpayers. True beer manufacturers will have sufficient motivation to have their products posted on the Internet list required by Regulation 2559.3, so that their purchasers may receive the benefit of Regulation 2559.5's safe harbor. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- P. Mr. Sorini states that Chairwoman Yee conceded the Board’s lack of authority to classify FMB at the Board’s August 14, 2007, public hearing when she stated “this Board doesn’t have authority in the form of specific legislative authorization to classify flavored malt beverages.”

Response

This comment takes Ms. Yee’s comment out of context. In fact, the Board has a broad, general authority, conferred by the Legislature, that authorizes the Board to adopt regulations necessary to administer the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code § 32451). Accordingly, the Board made no changes to the Regulations as a result of this comment.

- Q. In footnote 12, Mr. Sorini states “[e]ach of the arguments set out in this letter apply equally to flavored wines should the Board clarify that the proposed regulations apply to wines flavored with the same types of flavors used in FMBs; *i.e.*, flavors derived from grain neutral spirits . . . rather than brandy.”

Response

Assuming this is a request to consider clarifying language, no clarification is required. The Regulations provide specific language that if a product falls within the statutory definition of “wine” (Bus. & Prof. Code, § 23007), then the Regulations do not apply. If, however, the product does not fall within the statutory definition of “wine,” then the Regulations would apply. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- R. The Legislature cannot have intended for FMB to be “beer” under the Alcoholic Beverage Control Act and “distilled spirits” under the Alcoholic Beverage Tax Law and the Board has the burden, therefore, of establishing that the Legislature intended this result.

Response

The Alcoholic Beverage Tax Law and the Alcohol Beverage Control Act are different statutory schemes with different purposes. The statutes are clear with respect to the Board’s general regulatory authority under the Alcoholic Beverage Tax Law. Additionally, the Legislature has not prohibited differences in classification for tax assessment and licensing purposes, respectively. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- S. The Board does acknowledge in its Hearing Notice that the “proposed regulations may impact small business.” Mr. Sorini comments that the Board provides no explanation of the statement.

Response

Office of Administrative Law regulations provide that a determination is required, but no evidence or explanation is required. (Cal. Code Regs., tit. 1, § 4.) Accordingly, the Board has met its requirement and no changes were made to the Regulations based on this comment.

Comment 4: Paul Kronenberg, President, Family Winemakers of California

In a letter dated November 14, 2007, written on behalf of the Family Wine Makers of California, Mr. Kronenberg wrote in opposition to the proposed Regulations. In summary, Mr. Kronenberg set forth the following comments:

- A. By allowing the Board to act in clear excess of its authority, the proposed Regulations introduce uncertainty and confusion into the regulatory scheme governing California's regulation of alcoholic beverages.

Response

The Board has the authority to promulgate regulations for purposes of administering the Alcoholic Beverage Tax Law. (See Response to 45-day Written Comment 3.C., above.) The adopted Regulations clarify when an alcoholic beverage meets the definition of a "distilled spirit" or a "beer." Further, the adopted Regulations, taken as a whole, and in particular the safe harbor provision of Regulation 2559.5, *Correct Classification*, provide a bright line to assist taxpayers in properly reporting and paying taxes required to be administered by the Board. The compliance burdens associated with the adopted Regulations are minimal and these Regulations do not impact in any manner ABC's licensing responsibilities. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. The proposed regulations would unduly and unnecessarily burden California's wine producers by forcing those producers to overcome, on an annual basis, the presumption that both flavored and unflavored wines are "distilled spirits."

Response

There is no annual requirement set forth in the adopted Regulations. In the absence of a reformulation or evidence that the alcoholic beverage in question has not been properly classified, the sworn report required to rebut the presumption of taxation as a distilled spirit need only be proffered one time.

The Board has excluded "wine," as defined under the Alcoholic Beverage Tax Law, from the adopted Regulations because the Board recognizes that it cannot exceed its regulatory authority by seeking to clarify a statutory classification that does not appear to require any clarification. "Wine," as defined by Business and Professions Code section 23007, specifically allows for the inclusion of certain distilled components. Therefore, unlike the definition of "beer," the statutory definition of "wine" specifically provides for certain mixtures or additions of alcohol obtained from distillation. No similar clarification is required with respect to which products are within the definition of "wine."

The adopted Regulations do not subject the wine industry to any undue or unnecessary burdens. If the alcoholic beverage meets the statutory definition of "wine," then the product will be taxed as a "wine." Absent any evidence to the contrary, including corroboration from ABC that a particular product does not fit neatly within the statutory definitions of "wine" or "distilled spirits," ABC's determination of a "wine" for licensing purposes will be followed for

purposes of taxation.³ As discussed above, the statutory definition of “wine” provides in specified instances for the inclusion of distilled alcohol. If a product does not meet the statutory definition of “wine,” then the product will be subject to the adopted Regulations. This is the case for any alcoholic beverage.

Accordingly, no changes were made to the Regulations adopted by the Board.

- C. Proving that a particular wine product (1) is a “wine” within the meaning of Business and Professions Code section 23007; or (2) is not a “distilled spirit” within the meaning of Regulation 2558 of the proposed regulations, will require California wine producers to disclose valuable trade secrets that will erode the competitive advantage California’s ultra-premium wine makers share over the competition.

Response

To the extent a California wine producer makes a product that does not meet the statutory definition of “wine” (Bus. & Prof. Code, § 23007), see Response to 45-day Written Comment 3.G., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- D. The proposed Regulations could expose California’s smallest wine producers to retaliatory action from other states. Such action could adversely affect California’s tax base.

Response

How another state may react to the Board’s regulatory action, while important, cannot prevent the Board from exercising its exclusive power to promulgate regulations to clarify the classification of alcoholic beverages for purposes of tax assessment and collection. The Legislature has already treated alcoholic products differently by providing different definitions for alcoholic beverages. The Board is within its authority (Rev. & Tax. Code, § 32451; Bus. & Prof. Code, § 23051), for tax purposes, to clarify statutory definitions, where, as discussed above, clarity is required.

Accordingly, no changes were made to the Regulations adopted by the Board.

- E. “[C]onstitutional amendments, which reflect how Article [XX, § 22] reads in its current form, were adopted for the sole purpose of removing all jurisdiction from BOE except for the imposition and collection of taxes.”

Response

See Response to Oral Comment 2.C., and Response to 15-day Written Comment 2.C., below. Accordingly, no changes were made to the Regulations adopted by the Board.

- F. The Board is usurping ABC’s exclusive authority despite a legislative desire that the definitions applicable to licensing, manufacture, importation, and sale contained in Division 9 of the Business and Professions Code are to govern construction of the statutes related to taxation contained in Part 14 of the Revenue and Taxation Code.

³ As discussed in Response to 45-day Written Comment 7, below, with respect to FMB, ABC has corroborated the Board’s understanding that FMB do not fit neatly within the definition of either “beer” or “distilled spirits.”

Response

See Response to 45-day Written Comment 14., and Response to 15-day Written Comment 2.D., below. The Board is mandated to administer the Alcoholic Beverage Tax Law. Revenue and Taxation Code 32002 requires that the Board utilize certain definitions found in the Alcoholic Beverage Control Law. The Board has determined that the definition of “distilled spirits” requires clarity with respect to FMB. Based on general regulatory authority granted to the Board in Revenue and Taxation Code section 32451, the Board has the authority to adopt regulations relating to the administration of the Alcoholic Beverage Tax Law (i.e., Part 14, Division 2, of the Revenue and Taxation Code). The adopted Regulations are not for purposes of the Alcoholic Beverage Control Act. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Comment 5: Mike Falasco, Director, California State Relations, Wine Institute

In a letter dated November 14, 2007, written on behalf of the Wine Institute, Mr. Falasco wrote in opposition to the proposed Regulations. In summary, Mr. Falasco set forth the following comments:

- A. The Department of Alcoholic Beverage Control has the exclusive right to classify alcoholic beverages for all purposes, including purposes under the Alcoholic Beverage Tax Law.

Response

See Response to 45-day Written Comment 3.C., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. The proposed Regulations conflict with the statute defining “distilled spirits.”

Response

See Response to 45-day Written Comment 3.A. and 3.B., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. The proposed Regulations would cause confusion, especially among retailers, and related significant economic dislocation and harm.

Response

See Response to 45-day Written Comment 3.H., above.

With respect to retailers, there should be no confusion. Contrary to Mr. Falasco’s comment that a retailer “would be confused as to whether FMBs should be merchandized as distilled spirits or beer,” retailers should not be confused. The adopted Regulations do not impact ABC’s licensing or federal labeling laws. Retailers would retain their current licenses, which would include “beer” licenses for FMB and federal labeling would continue to be mandated under federal law.

Accordingly, no changes were made to the Regulations adopted by the Board.

- D. The proposed Regulations are an improper response to the problem of underage drinking.

Response

The Board agrees that consumption of alcohol by underage youth is a serious problem. However, this rulemaking pertains to the correct classification of FMB for the purpose of taxation under the Alcoholic Beverage Tax Law. Accordingly, no changes were made to the Regulations adopted by the Board.

- E. The Department of Alcoholic Beverage Control interprets the definitions of “beer,” “wine,” and “distilled spirits” to classify the various types of alcoholic beverage products in order to determine how to license industry members and regulate their conduct. (Bus. & Prof. Code, § 23355.) Once the Department of Alcoholic Beverage Control has done this, the classification must be binding on other state agencies. Otherwise, there would not be a “uniform administration and enforcement of the liquor laws.” (Bus. & Prof. Code, § 23049.)

Response

Business and Professions Code sections 23355 and 23049 are both found in the Alcoholic Beverage Control Act (Act). The Act governs the licensing of alcohol for which the Alcoholic Beverage Control Board has exclusive jurisdiction. The Regulations adopted by the Board are for purposes of the Board’s exclusive authority to assess and collect the taxes imposed on the manufacture, importation and sale of alcohol. In order to assess and collect the taxes, the Board has the authority to adopt regulations. (See Rev. & Tax. Code, § 32451.) The Regulations adopted by the Board do not impact in any manner licensing. Further, section 23049 applies to “liquor laws.” There is no requirement that they apply to tax laws. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- F. Board’s staff and legal counsel have acknowledged a concern that the Legislature intended for the Alcoholic Beverage Control Board to have primary authority to determine the classification of alcoholic beverages for all California purposes. Mr. Falasco sets forth excerpts from two letters to support this statement.

Response

The comment misinterprets the quotations cited. While Mr. David Gau, Deputy Director of the Board’s Property & Special Taxes Department, has stated that “[t]he [Board’s] Legal Department’s review of California law indicates that the Legislature may have intended that the Department of Alcoholic Beverage Control have primary authority,” this statement is not intended to suggest an “exclusive” authority was afforded the Alcohol Beverage Control Board. As discussed repeatedly above, under both the Constitution and statutory law, the Board has complete authority to administer the Alcoholic Beverage Tax Law. Moreover, while Ms. Kristine Cazadd, the Board’s Chief Council, has stated that “[t]he California State Board does not normally classify alcoholic beverages,” that does not mean that the Board could not or would not classify alcoholic beverages for tax purposes if, as here, clarification is needed to effectively administer the Alcoholic Beverage Tax Law.

Additionally, although the Board respectfully disagrees with certain aspects of the above-discussed opinion of the Legislative Counsel of California (see 45-day Written Comment 2.,

and Response to 45-day Written Comment 2., above), the Legislative Counsel has opined that the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law, interpret the terms “distilled spirits,” “beer,” and “wine” as long as it is consistent with those terms as set forth in the relevant statutes and as validly interpreted by ABC. The Board’s adoption of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 is consistent with the relevant statutory language and is not contrary to any regulation promulgated by ABC.

Accordingly, no changes were made to the Regulations adopted by the Board.

Comment 6: Lara Diaz Dunbar, Vice President, Government Affairs & Public Policy, California Restaurant Association (CRA) In a letter dated November 14, 2007, written on behalf of the CRA, Ms. Dunbar wrote in opposition to the proposed Regulations. In summary, Ms. Dunbar set forth the following comments:

- A. The CRA believes that reclassification is fatally flawed and fails to present feasible, cost-effective solutions to implement the reclassification and, given California’s current budget deficit, is a costly financial burden.

Response

See Response to 45-day Written Comment 3.A. and 3.H., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. Reclassifying FMB will not reduce underage drinking.

Response

See Response to 45-day Written Comment 5.D., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. Reclassifying will give the wine industry a competitive advantage and economically hinder law-abiding foodservice businesses, especially smaller independently owned restaurants.

Response

The Board has excluded “wine,” as defined by statute, from the adopted Regulations because the definition of “wine” (Bus. & Prof. Code, § 23007) specifically allows for the inclusion of certain distilled components. To the extent this provides any advantage to the wine industry, it is an advantage conferred by the California Legislature, not the Board. Ultimately, however, the wine industry is not in a different position. If a particular product does not meet the statutory definition of “wine,” then the product will be subject to the adopted Regulations. This is the case for any alcoholic beverage. There is no greater or lesser burden. Accordingly, no changes were made to the Regulations adopted by the Board.

With respect to the impact of the adopted Regulations to retailers/restaurants, see Response to 45-day Written Comment 3.H., above. Further, no persuasive evidence exists of “smaller independently owned restaurants” being jeopardized. The adopted Regulations do not impact ABC’s licensing. Retailers, regardless of their size, would retain their current licenses. Accordingly, no changes were made to the Regulations adopted by the Board.

D. Reclassifying FMB would not properly classify this new segment of the beer industry.

Response

See Response to 45-day Written Comment 3.A., above. Accordingly, no changes were made to the Regulations adopted by the Board.

Comment 7: Comments of the California Department of Alcoholic Beverage Control (ABC)

In a document dated November 14, 2007, ABC submitted comments. The following summarizes the comments:

A. ABC comments that “[w]here products are clearly defined, it is appropriate for BOE to exercise their regulatory power, but not when clarification is needed from the Legislature.”

Response

The regulatory action was adopted based on the Board’s authority pursuant to Revenue and Taxation Code section 32451 to adopt regulations for purposes of the Alcoholic Beverage Tax Law. Moreover, as ABC has previously admitted to the California Court of Appeal, First Appellate District, the Board, not ABC, has the exclusive power to classify alcoholic beverage for purposes of taxation. (See Bus. & Prof. Code, § 23051; see also Exhibit 1 to ABC’s 45-day written comments, at p. 14.) Although ABC believes that legislative intervention is preferable to Board regulatory action, ABC is well aware that its preference is not mandated by law. As page 14 of Exhibit 1 to ABC’s 45-day written comments makes clear, in a Memorandum of Points and Authorities filed in support of its Answer to Petition for Writ of Mandate (dated January 26, 2006), ABC correctly stated that: “Moreover, while the definitions of beer, wine and distilled spirits are found in the ABC Act (Bus. & Prof. Code §§ 23000 et seq.), and are incorporated by reference into the Revenue and Taxation Code (Rev. & Tax. Code § 32002), neither statute empowers or authorizes the ABC to direct BOE how to classify any product for taxation purposes. [footnote]” In the accompanying footnote, ABC stated: “Indeed, BOE has, in the past, simply deferred to ABC’s classification of products [citation omitted]. Such deference is not required by law, and BOE is free to tax products as it deems appropriate.”

While the Legislature, to the extent it believes the adopted Regulations fail to adequately clarify the distinctions between “beer” and “distilled spirits” for tax purposes, is certainly empowered to abrogate the adopted Regulations, the Legislature’s current inactivity does not prevent the Board from exercising its exclusive regulatory power in this area.

Additionally, although the Board respectfully disagrees with certain aspects of the above-discussed opinion of the Legislative Counsel of California (see 45-day Written Comment 2 and Response to 45-day Written Comment 2, above), the Legislative Counsel has opined that the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law, interpret the terms “distilled spirits,” “beer,” and “wine” as long as it is consistent with those terms as set forth in the relevant statutes and as validly interpreted by ABC. The Board’s adoption of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 is consistent with the relevant statutory language and is not contrary to any regulation promulgated by ABC.

Accordingly, no change was made to the regulatory language adopted by the Board.

- B. ABC comments that “[b]ecause the statutes and definitions **are** ambiguous and potentially subject to multiple and contradictory interpretations, the Department believes that the policy debate and final resolution **should be made by the Legislature**. . . . A clarification or contrary determination is appropriate for a Legislative resolution so as to ensure that conflicting treatments by two state agencies for a single product not happen.” (Emphasis in original.)

Response

See Response to 45-day Written Comment 7.A., above. Accordingly, no change was made to the regulatory language adopted by the Board.

- C. Contradictory and conflicting treatment and statutory interpretation such as would be caused by the Board’s regulatory action would disrupt the orderly marketing of these controlled and regulated products. Such conflicting treatment would also create confusion in the market place and confusion of the law.

Response

See Response to 45-day Written Comments 3.H., 4.A., and 6.C., above. There should be no substantial or persistent confusion on the part of taxpayers or retailers. The adopted Regulations provide clear guidance for tax classification purposes. Moreover, the adopted Regulations do not impact ABC’s licensing or federal labeling laws. No disruption of the market would occur because licensees would retain their current licenses, which allow FMB to be sold as “beer” as labeled under federal law.

Accordingly, no changes were made to the Regulations adopted by the Board.

Comment 8: Judy Walsh-Jackson, Chair, on behalf of the California Coalition on Alcopops and Youth (Youth Coalition)

In a letter dated November 8, 2007, written on behalf of the Youth Coalition, Ms. Walsh-Jackson submitted comments in support of the Board’s regulatory action. The following summarizes the comments:

- A. The Regulations are consistent with, and authorized by, state law.

Response

The Board generally agrees with the Youth Coalition’s comment. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. The proposed Regulations provide much-needed clarity to both the Board and to taxpayers on the issue of what constitutes a distilled spirit.

Response

The Board generally agrees with the Youth Coalition's comment. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. The proposed Regulations are the best available alternative.

Response

The Board generally agrees with the Youth Coalition's comment. Accordingly, no changes were made to the Regulations adopted by the Board.

- D. The proposed Regulations will have only minimal impact on manufacturers.

Response

The Board generally agrees with the Youth Coalition's comment. Accordingly, no changes were made to the Regulations adopted by the Board.

- E. The proposed Regulations will impose only a minimal financial burden on businesses.

Response

The Board generally agrees with the Youth Coalition's comment. Accordingly, no changes were made to the Regulations adopted by the Board.

Comment 9: California Flavored Beer Coalition (CFBC)

In a letter dated November 14, 2007, the CFBC submitted written comments in opposition to the proposed regulations. The following summarizes the comments:

- A. The Board does not have the resources nor the expertise to effectively administer the proposed change and the change is ill timed as the state considers budget reductions.

Response

The Board is mandated to administer the Alcoholic Beverage Tax Law. The current regulatory action is therefore required to clarify which alcoholic beverages meet the definition of "beer" and which ones meet the definition of "distilled spirits." In clarifying the taxation of FMB, the adopted Regulations were drafted to promote effective and efficient tax administration with the least amount of burden on taxpayers. Moreover, budgetary constraints, to the extent they exist, do not excuse the Board from its responsibility to exercise, when needed, its exclusive authority over the classification of alcoholic beverages for tax purposes. (Bus. & Prof. Code, § 23051.) In any case, the Board has no authority with respect to California's budget.

Accordingly, no changes were made to the Regulations adopted by the Board.

- B. There will be a negative impact on the Board and 35,000 small businesses.

Response

See Response to 45-day Written Comments 3.H., 4.A., 6.C., and 7.C., above. Further, the Board is not aware of any evidence that the adopted Regulations will have a negative impact on the Board. The Board is mandated to administer the Alcoholic Beverage Tax Law. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. CFBC states in its June 21, 2007, letter attached to its November 14, 2007, comment that the 0.5% alcohol by volume threshold has already been rejected by the TTB.

Response

See Response to 45-day Written Comment 3.D., above. Additionally, this is a statement of fact and has no legal effect. Further, there is no requirement that the Board follow exactly federal law. Revenue and Taxation Code section 32152 provides only for “coordination.” Accordingly, the Board made no changes to the Regulations as a result of this comment.

- D. CFBC states in its June 21, 2007, letter attached to its November 14, 2007, comment that “California law mandates consistency with federal law.”

Response

See Response to 45-day Written Comment 3.D., above. Additionally, there is no requirement that the Board follow exactly federal law. Revenue and Taxation Code section 32152 provides only for “coordination,” when appropriate. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- E. CFBC states in its June 21, 2007, letter attached to its November 14, 2007, comment that “it is unclear how the BOE would endeavor to analyze manufacturers’ product ‘formulas’....”

Response

The Board does not intend to conduct technical analyses of product formulas. Regulation 2558 sets forth a “bright-line” standard. Manufacturers can rebut Regulation 2559’s presumption, which is related to Regulation 2558’s standard, with an accurate report under penalty of perjury pursuant to Regulation 2559.1. When verification of a report is warranted, any “Statement of Process” or “Formula” reviewed by the Board will simply be looked at for corroboration that, as sworn, a particular product does not contain 0.5 percent or more alcohol by volume from flavors or other ingredients containing alcohol obtained from the distillation of fermented agricultural products. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- F. CFBC states in its February 16, 2007, letter attached to its November 14, 2007, comment that “[f]lavored beer should remain classified as a beer because according to the Federal Government it is beer.”

Response

Revenue and Taxation Code section 32152 does not mandate that the classification of beer for purposes of the Alcoholic Beverage Tax Law follow exactly the federal government's classification system (rather, only "coordination," when appropriate, is required). See Response to 45-day Written Comment 3.D., above. Moreover, to the extent an FMB product meets the definition of distilled spirits, Revenue and Taxation Code section 32152 is inapplicable. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- G. CFBC states in its February 16, 2007, letter attached to its November 14, 2007, comment that "[m]inority owned businesses would be especially impacted."

Response

See Response to 45-day Written Comment 3.H., above. The Board has determined that there is no significant adverse economic impact on private business or persons. Additionally, CFBC has provided no evidence or given any explanation for its statement. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Comment 10: Peggy Buckles

In an e-mail message dated September 28, 2007, Ms. Buckles, member of the 12th District PTA, wrote that she was "writing to ask that the Flavored Malt Beverages be taxed at the same rate as distilled spirits. These drinks are marketed to teens and this additional tax will, hopefully, make them too expensive for teens to purchase. In addition, the alcohol content is more in line with that of distilled spirits than of beer."

Response

See Response to 45-day Written Comment 5.D., above. The Board hereby acknowledges the written comment. The Board made no changes to the Regulations as a result of this comment.

Comment 11: Sep Whaley

In an e-mail message dated September 28, 2007, Sep Whaley, member of the 12th District PTA, wrote that he or she was "writing to ask that the Flavored Malt Beverages be taxed at the same rate as distilled spirits. These drinks are marketed to teens and this additional tax will, hopefully, make them too expensive for teens to purchase. In addition, the alcohol content is more in line with that of distilled spirits than of beer."

Response

See Response to 45-day Written Comment 5.D., above. The Board hereby acknowledges the written comment. The Board made no changes to the Regulations as a result of this comment.

Comment 12: Lou Langkusch

In an e-mail message dated September 28, 2007, Mr. Langkusch, member of the 12th District PTA, wrote that he was “writing to ask that the Flavored Malt Beverages be taxed at the same rate as distilled spirits. These drinks are marketed to teens and this additional tax will, hopefully, make them too expensive for teens to purchase. In addition, the alcohol content is more in line with that of distilled spirits than of beer.”

Response

See Response to 45-day Written Comment 5.D., above. The Board hereby acknowledges the written comment. The Board made no changes to the Regulations as a result of this comment.

Comment 13: Wendy Laufer

In an e-mail message dated September 28, 2007, Ms. Laufer, member of the 12th District PTA, wrote that she was “writing to ask that the Flavored Malt Beverages be taxed at the same rate as distilled spirits. These drinks are marketed to teens and this additional tax will, hopefully, make them too expensive for teens to purchase. In addition, the alcohol content is more in line with that of distilled spirits than of beer.”

Response

See Response to 45-day Written Comment 5.D., above. The Board hereby acknowledges the written comment. The Board made no changes to the Regulations as a result of this comment.

Comment 14: Gene Livingston, Esq., Greenberg Traurig, LLP, on behalf of Miller Brewing Company (Miller)

On behalf of Miller, in a brief with separate appendices, Mr. Livingston wrote in opposition to the proposed Regulations. In summary, Mr. Livingston set forth the following comments:

- A. The Board has no authority to adopt the proposed Regulations because the Board’s authority to adopt regulations does not reach to interpreting the statutory definitions of “beer,” “wine” and “distilled spirits”; the Department of Alcoholic Beverage Control (ABC) has the exclusive authority to define these statutory terms, and the Board is obligated to follow the ABC’s classifications of alcoholic beverages, notwithstanding any concerns the Board may have about underage drinking.

Response

See Responses to 45-day Written Comments 3.C., 5.D., and 7., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. The adopted Regulations are inconsistent with the statutes they purport to interpret or make specific.

Response

See Responses to 45-day Written Comments 3.A. and 3.B., above. Accordingly, no changes were made to the Regulations adopted by the Board.

C. The classification of flavored malt beverages should be left for the Legislature to address.

Response

See Response to 45-day Written Comment 7., above. Accordingly, no changes were made to the Regulations adopted by the Board.

D. The separate appendices Mr. Livingston submitted with his brief, which he also referenced in his oral comments on behalf of Miller, are comprised of the following:

- (1) Full Text of Proposition 3 – Alcoholic Beverage Control (6 pages); and
- (2) 38 pages of various newspaper articles.

Response

See Response to Oral Comment 2., below. As explained below, no changes were made to the Regulations adopted by the Board.

E. The Regulations adopted provide a different definition of distilled spirits, omitting the portions of the statutory definition that created the uncertainty.

Response

The comment does not provide how the Regulations omit portions of the statutory definition of distilled spirits. The Regulations adopted by the Board do not omit any portions of the statutory definition of distilled spirits. The Regulations clarify the statutory definition. Accordingly, the Board made no changes to the Regulations as a result of this comment.

F. Mr. Livingston states “[t]hat history demonstrates that neither the Legislature nor the people would have conferred on the BOE any authority for classifying alcoholic beverages” and “[t]o give the BOE any discretion could be subject to the same abuse that had been dramatically and visibly revealed by the work of the Weinberger committee.”

Response

The history set forth by Mr. Livingston from the time of the passing of Proposition 3 is not directly relevant and does not establish that the Board lacks the authority to interpret and implement the Alcoholic Beverage Tax Law for purposes of assessing and collecting tax. ABC has the authority to regulate most aspects of alcoholic beverages, but the Board has the power to assess and collect taxes for alcoholic beverages. As discussed repeatedly above, it is under the Board’s clear authority to assess and collect taxes that these Regulations have been adopted. Clarity is required to assess and collect taxes with respect to alcoholic beverages that contain distilled spirits. Revenue and Taxation Code section 32451 provides the Board general authority to adopt regulations necessary to administer the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

G. Mr. Livingston challenges the Board’s authority under Revenue and Taxation Code section 32451 to adopt the Regulations. He states that “[b]y its express terms, Revenue and Taxation Code

section 32451 only authorizes the BOE to adopt regulations relating to its administration and enforcement of Part 14 of the Revenue and Taxation Code.”

Response

Revenue and Taxation Code section 32451 provides the Board general authority to promulgate regulations for the Alcoholic Beverage Tax Law. The Board is utilizing this authority in order to clarify, under the Alcoholic Beverage Tax Law, the definition of “distilled spirits,” which definition (Bus. & Prof. Code, § 23005) is specifically incorporated by reference into Part 14, the Alcoholic Beverage Tax Law, by Revenue and Taxation Code section 32002. Business and Professions Code section 23005 is, therefore, set forth in Part 14, the Alcoholic Beverage Tax Law, and the Board has general authority to promulgate regulations pursuant thereto. (Rev. & Tax. Code, § 32451.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

H. Revenue and Taxation Code section 32452 is not a proper reference section.

Response

Revenue and Taxation Code section 32452 is set forth to assist the reader in finding relevant code sections applicable to Regulation 2559.1. Regulation 2559.1 allows a manufacturer to file a “report” and Revenue and Taxation Code section 32452 allows the Board to request “reports.” Accordingly, the Board made no changes to the Regulations as a result of this comment.

I. Business and Professions Code section 25750 expressly authorizes the ABC to implement, interpret, or make specific the definitions set forth in Business and Professions Code, section 23000 et seq. and Section 22 of Article XX of the California Constitution.

Response

The Board does not disagree that Business and Professions Code section 25750 provides ABC regulatory powers for the Alcoholic Beverage Control Act and that ABC possesses other powers set forth in Article XX, section 22 of the Constitution. ABC’s regulatory authority, however, does not negate the Board’s authority to assess and collect taxes and adopt regulations relating to the administration and enforcement of the Alcoholic Beverage Tax Law. (See Response to 45-day Written Comment 2., above) With the phrase “except as herein provided” in Article XX, section 22 of the Constitution, the Legislature specifically carved out from ABC’s authority the Board’s authority to assess and collect taxes. (See Cal. Const., art. XX, § 22.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

J. Section 22 of Article XX of the California Constitution makes clear the Board’s role in alcoholic beverage regulation is limited to the assessment and collection of excise taxes.

Response

Section 22, Article XX confers ABC exclusive authority, “except as herein provided,” to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes. (See Cal. Const., art. XX, § 22.) With the phrase “except as

herein provided,” the Legislature specifically carved out the Board’s authority, set forth later in Section 22, to “assess and collect such excise taxes as are or may be imposed by the Legislature.” (*Id.*) Further, the Legislature enacted the Alcoholic Beverage Tax Law (see Rev. & Tax. Code, § 32001 et seq.) and gave the Board rulemaking authority under the same. (Rev. & Tax. Code, § 32451.) The Regulations clarify the definition of “distilled spirits” for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- K. Additional evidence of ABC’s exclusive authority to classify alcoholic beverage comes from Business and Professions Code section 23049.

Response

The Board does not agree with this comment. Business and Professions Code section 23049 provides as follows:

“It is the intention of the Legislature in enacting this *chapter* to provide a governmental organization which will ensure a strict, honest, impartial, and uniform administration and enforcement of the liquor laws throughout the State.”
(Emphasis added.)

This section applies to the “chapter” which is “Chapter 1.5. Administration” of Division 9 of the Alcoholic Beverage Control Act. This section does not apply to the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code, § 32001 et seq.) Additionally, the Alcoholic Beverage Tax Law and the Alcoholic Beverage Control Act are different statutory schemes with different purposes. The statutes are clear with respect to the Board’s general regulatory authority under the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code, § 32451.) The Board, under its authority, is interpreting and implementing tax laws, not the liquor laws referred to in Business and Professions Code section 23049. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- L. The principle of statutory construction known as *expressio unius est exclusio alterius* weighs against the Board having authority for the Regulations.

Response

Miller comments that the rule of statutory construction, *expressio unius est exclusio alterius* (i.e., the expression of certain things in a statute necessarily involves the exclusion of other things not expressed) means that no other agency has the authority to make and prescribe regulations necessary and proper to administer the Alcohol Beverage Control Act. First, as stated above, the Regulations are adopted under the Alcoholic Beverage Tax Law in order to clarify for the purpose of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.” The Regulations do not apply to the Alcoholic Beverage Control Act. Second, contrary to Miller’s comment, the statutory language of Business and Professions Code section 25750 does not preclude the Board from adopting regulations for tax purposes, as the Board is authorized to do by Revenue and Taxation Code section 32451. (See Response to 45-day Written Comment 2., above).

Business and Professions Code section 25750 simply provides ABC with general regulatory authority for the Alcoholic Beverage Control Act and any other authority conferred under Article XX, section 22 of the Constitution, other than the authority specifically carved out of ABC's authority and given to the Board. Specifically, the Legislature gave the Board authority to assess and collect taxes under the Alcoholic Beverage Tax Law. (See Cal. Const., art. XX, § 22.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- M. Mr. Livingston states "The relevant provisions of the Alcoholic Beverage Tax Law are in pari material with statutes in the Alcoholic Beverage Control Act that pertain to ABC's classification of Alcoholic Beverages and therefore must be construed consistently."

Response

Mr. Livingston appears to be commenting that because both the Alcoholic Beverage Tax Law and the Alcoholic Beverage Control Act pertain to alcoholic beverages, the same topic, they must be construed the same. While both laws pertain to alcoholic beverages they are not, however, the same. The Alcoholic Beverage Control Act applies the *licensing* of the manufacture, importation and sale of alcoholic beverages in this State, but the Alcoholic Beverage Tax Law applies to the *taxation* of the manufacture, importation, and sale of alcoholic beverages. The laws are not the same. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- N. Mr. Livingston comments that Board Member Yee's statement on August 14, 2007, is the statement of the Board and that therefore her statement regarding underage drinking is the motivation for the Board's adoption of the Regulations.

Response

A comment by a Board Member is a comment of the individual member. The Board can only act as a whole. The Board voted on the record that the necessity for the Regulations was tax administration, not temperance. Additionally, Ms. Yee's comments were made to begin formal rulemaking. The formal rulemaking and the Board's ultimate vote to adopt the Regulations was made in order to clarify, for tax purposes, the definition of "distilled spirits." Accordingly, the Board made no changes to the Regulations as a result of this comment.

- O. Regulation 2558 is inconsistent with the statutory definition of "distilled spirits" in Business and Professions Code section 23005 because section 23005 requires that the product resulting from distillation has to be an alcoholic beverage. Further, the statutory construction principal *ejusdem generis* further shows the inconsistency between the BOE's proposed regulation and the definition because the general category is restricted to items similar to those which are enumerated specifically. Since FMBs do not contain "alcohol for beverage use, spirits of wine, whiskey, rum, brandy, and gin, it is not a "distilled spirit" as a matter of law.

Response

The Board's regulatory action is premised on its determination (see Introduction, at p. 2 and following, above) that the definition of "distilled spirits" requires clarification. (See Bus. & Prof. Code, § 23005). Contrary to Miller's comment regarding the reading of the definition of "distilled spirits," the final six words of the statutory definition of "distilled spirits" (i.e.,

“including all dilutions and mixtures thereof”) can be read to establish that any alcoholic beverages containing distilled spirits fall within the definition of distilled spirits (Bus. & Prof. Code, § 23005). Since an alcoholic beverage containing any amount of distilled spirits could fall within the definition of distilled spirits, the 0.5 percent threshold set forth in Regulation 2558 is consistent with governing law.

P. Regulation 2558 redefines the definition of “distilled spirits” and eliminates the phrase “alcoholic beverage.”

Response

Contrary to Miller’s comment, the definition of “distilled spirits” remains and the phrase “alcoholic beverage” was not removed. Regulation 2558 simply provides clarification by providing clear, objective guidance to taxpayers with respect to which alcoholic beverages meet the definition of “distilled spirits.”

Received after the 45-day comment period

Comment 15: Honorable Bill Leonard, Member, Board of Equalization, Second District

After the close of the 45-day comment period, in a letter dated November 16, 2007, Board Member Bill Leonard objected to the adoption of the proposed rules. For the sake of completeness and because comments preceding the 45-day comment period are included as part of the rulemaking record, as requested by Mr. Marc E. Sorini (see 45-day Written Comment 3.I. and Response to 45-day Written Comment 3.I., above), Mr. Leonard’s letter is also included in the rulemaking record at tab 24, OAL File No. 07-1210-035.

Comment 16: North Coastal Prevention Youth Coalition (NCP Youth Coalition)

After the close of the 45-day comment period, on November 16, 2007, the Board received 18 postcards from the NCP Youth Coalition. The postcards provide the following:

“Dear Board of Equalization: THANK YOU for your vote to correctly tax alcopops as distilled spirits. This effort by the BOE will bring \$53 million dollars more to the state, and even more importantly, it will help reduce underage drinking.”

For the sake of completeness and because comments preceding the 45-day comment period are included as part of the rulemaking record, as requested by Mr. Marc E. Sorini (see 45-day Written Comment 3.I. and Response to 45-day Written Comment 3.I., above), NCP Youth Coalition’s submissions are also included in the rulemaking record at tab 23, OAL File No. 07-1210-035.

Oral Comments

The following oral comments were made at the November 15, 2007, Board meeting in Sacramento, California.

Speaking In Opposition:

Comment 1: Mr. Marc E. Sorini, representing the Flavored Malt Beverage Coalition (Coalition)

Mr. Sorini first stated that the Coalition would stand on their written submission but would like to emphasize three points. The following is a summary of the three points:

A. First, the proposed Regulations are inconsistent with the governing statutes and law.

- A flavor is a nonbeverage product under Business and Professions Code section 23112, yet the Regulations say that by adding a flavor containing sufficient alcohol obtained from distillation to a beer causes the beer to transform into a distilled spirit.
- The proposed Regulations rewrite the operative language of the distilled spirits statute that speaks to a beverage product, as the Regulations change the language “alcoholic beverage” to “product containing distilled alcohol.”
- The presumption created by the Regulations that all beer are distilled spirits until such time as affirmative action is taken to rebut the presumption is inconsistent with the statute.

B. Second, the Board lacks the authority to regulate in the manner proposed.

- The sole authority to regulate rests per the California Constitution with the Department of Alcoholic Beverage Control (ABC), and the ABC agrees with that position.
- The Board’s authority is quite constrained and consists of assessing and collecting tax on account of those activities that have been regulated and defined by the ABC.
- The Board’s reason for acting is a temperance concern related to underage drinking that is within the exclusive jurisdiction of the ABC.

C. Third, the adopted Regulations create ambiguity with respect to the status of wine.

- The exemption of wine from the Regulations is discriminatory treatment towards beer.
- If the wine industry is affected, then the wine industry must be given adequate notice and opportunity to respond; if the wine industry is unaffected, this disparate treatment is arbitrary and in violation of the Commerce Clause.

Response

See Response to 45-day Written Comments 3., 6.C., and 7., above. Additionally, the wine industry was given proper notice of this regulatory process. The Notice provides that the Regulations are to clarify when “an alcoholic beverage meets the definition of ‘distilled spirits’ or ‘beer’.” This notice language can reasonably include wine, an alcoholic beverage. Additionally, the specific language of Regulation 2558 provides that it applies to “any alcoholic beverage, except wine as defined by Business and Professions Code section 23007....” The Board also notes that there have been submissions by several wine groups. Accordingly, the Board made no changes to the Regulations as a result of these oral comments.

Comment 2: Mr. Gene Livingston, representing the Miller Brewing Company

Mr. Livingston introduced himself as the former Director of the Office of Administrative Law (OAL), appearing on behalf of the Miller Brewing Company. The following is a summary of Mr. Livingston’s comments:

A. Mr. Livingston stated that, if he was still Director of OAL and these Regulations came to him today, he would reject them for the following grounds, which were also mentioned by Mr. Sorini:

- First, the Board does not have authority to adopt the Regulations in question because ABC has the exclusive authority to classify alcoholic beverages for both licensing and taxation purposes; and
- Second, the Regulations are inconsistent with the statutes they purport to implement, interpret, or make specific.

Response

See Response to 45-day Written Comments 3. and 7., above, and Response to Oral Comment 1, above. Accordingly, no changes were made to the Regulations adopted by the Board.

B. Mr. Livingston concluded by urging the Board on behalf of Miller Brewing Company, and in harmony with the written comments of ABC (see 45-day Written Comment 7., above), to “drop” this regulation and to work with the Legislature to make a change rather than to adopt a regulation for which the Board has no authority.

Response

See Response to 45-day Written Comment 7., above. Accordingly, no changes were made to the Regulations adopted by the Board.

C. Mr. Livingston stated that the Board does not have authority to promulgate the proposed Regulations. He argued that this is evident by the history at the time that Proposition 3 was passed, which is today Section 22 of Article XX of the Constitution and which created the Department of Alcoholic Beverage Control. Mr. Livingston argues Section 22 gave ABC the exclusive authority to regulate alcohol and left to the Board the power to assess and collect taxes.

Response

The history at the time of the passing of Proposition 3 is not directly relevant and does not establish that the Board lacks authority to interpret and implement the Alcoholic Beverage Tax Law for purposes of assessing and collecting tax. ABC has the authority to regulate most aspects of alcoholic beverages, but the Board has the power to assess and collect taxes for alcoholic beverages. As discussed repeatedly above, it is under the Board’s clear authority to assess and collect taxes that these Regulations have been adopted. Clarity is required to assess and collect taxes with respect to alcoholic beverages that contain distilled spirits. Revenue and Taxation Code section 32451 provides general authority to adopt regulations necessary to administer the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this oral comment.

D. Mr. Livingston stated that ABC commented, “[y]ou [the Board] have the authority to collect taxes, but not to classify alcoholic beverages.”

Response

See 45-day Written Comment 2., Response to Written Comments 2., and 7. ABC's comment did not say that the Board does not have the authority to classify alcoholic beverages for tax purposes. ABC's comment reaffirmed its prior statement that the Board could tax products as the Board deems appropriate. Accordingly, the Board made no changes to the Regulations as a result of these oral comments.

- E. Mr. Livingston stated that the Board "could have said that FMBs are beer" and asked why the Board did not.

Response

The Board determined that FMB do not neatly fit either the statutory definition of "distilled spirits" or the statutory definition of "beer." However, the Board chose to clarify the definition of "distilled spirits" because its definition utilizes statutory language that allows for "dilutions or mixtures" whereas the definition of "beer" does not provide similar language. Additionally, the definition of "wine" provides for the addition of certain specified distilled spirits to wine. (See Bus. & Prof. Code, § 23007.) If the Legislature had wanted to include the addition of distilled spirits to "beer" it could have chosen similar language found in the definitions of "distilled spirits" or "wine." The Board made no changes to the Regulations as a result of this comment.

Speaking In Favor:Comment 3: Mr. Fred Jones, on behalf of the California Council on Alcohol Problems and the Alcopops and Youth Coalition

Mr. Jones stated that the Board followed a proper rulemaking process that he described as being long, deliberative and inclusive. He further opined that the Regulations meet the six criteria of proper regulatory language. Mr. Jones discussed the definition of "wine," per Business and Professions Code section 23007, and stated that the definition allows distilled spirits to be added to wine. Mr. Jones also commented that the definition of "beer" is limited, whereas the definition of "distilled spirits," pursuant to Business and Professions Code section 23005, is very broad in that it includes "all dilutions and mixtures thereof."

Mr. Jones explained that Assembly Bill 417 (Aghazarian) was passed by the Legislature two years ago and vetoed by the Governor. Mr. Jones views this action by the Legislature as an admission that FMB do not fit the definition of "beer."

Mr. Jones stated that it was unfortunate that the ABC has not acted upon the classification of FMB with respect to point-of-sale licensing issues, but that he views the Board as having the constitutional prerogative for purposes of taxation. He also observed that the Legislative Counsel opinion discussed above (see 45-day Written Comment 2 and Response to 45-day Written Comment 2) is contradicted by the Attorney General's opinion, previously expressed to the Board, that an alcoholic beverage that contains any amount of distilled spirits is a distilled spirit under California law. He further reminded the Board that, by adopting the Regulations in question, they would merely be exercising their constitutional prerogative to clarify the correct taxation of FMB.

Mr. Jones also discussed the 0.5-percent threshold of Regulation 2558 and stated his belief that this bright-line threshold will meet the Office of Administrative Law's concerns relating to establishing clear industry standards.

Response

The Board generally agrees with Mr. Jones's comments. However, the Board reiterates that it does not agree with certain aspects of the referenced Legislative Counsel's opinion (see Response to 45-day Written Comment 2, above). Accordingly, no changes were made to the Regulations adopted by the Board.

Comment 4: Mr. Michael Scippa, Advocacy Director, Marin Institute

Mr. Scippa thanked the Board for their majority decision in August to tax FMB correctly. He explained that industry was currently attempting to describe the Board action as a tax increase when the action is actually correcting a taxation error. He explained that the United States is the only country where certain manufacturers utilize a tax loophole of manufacturing these products from a flavored malt base rather than using vodka as is done in other countries. Mr. Jones also commented that efforts to correctly reclassify FMB as distilled spirits are ongoing in other states, as well.

Response

The Board hereby acknowledges the oral comment. The Board made no changes to the Regulations as a result of this comment.

Comment 5: Mr. Jimmy Jordan, California Friday Night Live Partnership, one of the original petitioners

Mr. Jordan stated it is the Board's responsibility to correctly tax alcopops [FMB]. He explained that he only has a high school education and he can clearly understand the language used in these Regulations. He further stated that alcopops contain distilled spirits and should be taxed accordingly and expressed his belief that alcopops are a "gateway" drink for youth to other alcoholic beverage products. Lastly, Mr. Jordan acknowledged that the adopted Regulations would not end the problem of underage drinking, but that these Regulations would serve as an important step in addressing this problem.

Response

See Response to 45-day Written Comment 5.D., above. The Board hereby acknowledges the oral comment. The Board made no changes to the Regulations as a result of this comment.

Comment 6: Ms. Katie E. Lucas, Government Relations Director, Girl Scout Councils of California

On behalf of the Girl Scout Councils of California and its approximately 300,000 members, Ms. Lucas commended the Board for doing its constitutional duty to correctly tax FMB as distilled spirits under California law and urged the Board to formally adopt the Regulations.

Response

The Board hereby acknowledges the oral comment. The Board made no changes to the Regulations as a result of this comment.

Comment 7: Ms. Janessa Madrid, Student

Ms. Madrid identified herself as a senior at Galt High School and commended and thanked the Board for moving forward with the Regulations.

Response

The Board hereby acknowledges the oral comment. The Board made no changes to the Regulations as a result of this comment.

15-day Written Comments*Received during the 15-day comment period:*Comment 1. Mr. Tom McCormick, Executive Director, California Small Brewers Association

In a letter dated April 4, 2008, written on behalf of the California Small Brewers Association (CSBA), Mr. McCormick wrote in opposition to the 15-day notice. In summary, Mr. McCormick set forth the following comments:

- A. The Board is creating an entirely new classification system premised on a presumption that all beers produced by a brewer are distilled spirits unless and until the brewer files a rebuttal report with the Board declaring that its beers do not contain more than 0.5 percent alcohol by volume from sources other than the fermented beer base. This classification by presumption method is a potentially fatal trap that places an undue burden on small brewers.

Response

Regulation 2559 establishes a rebuttable presumption that alcoholic beverages, except wine as defined by Business and Professions Code section 23007, contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. This regulation is necessary in order to assist the Board with classifying products that meet the 0.5 percent threshold provided in Regulation 2558. In the interest of administrative feasibility, this regulation rebuttably presumes that alcoholic beverages contain 0.5 percent alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. The Board understands that there are potentially thousands of alcoholic beverages which may meet the clarifying standard

set forth in Regulation 2558. Neither the Board nor the ABC possesses the necessary expertise to chemically analyze alcoholic beverages. Therefore, this presumption was utilized to place the burden of establishing which alcoholic beverages contain the requisite amount of alcohol from distillation on the parties with the actual knowledge of the contents of these beverages. This presumption also eliminates the undue delay and minimizes the administrative inefficiencies that would result from requiring the Board to analyze or review each alcoholic beverage sold in this state before tax could properly be assessed and collected.

The mechanism for rebutting the presumption set forth in Regulation 2559.1 allows the manufacturer to rebut the presumption with respect to any alcoholic beverage by filing a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The ability to rebut the presumption recognizes that many products may contain less than 0.5 percent alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products and that a manufacturer should be allowed to provide the Board with verifying information. Additionally, the report under penalty of perjury mechanism for rebuttal was selected to ensure that only a minimal burden is placed on manufacturers seeking to rebut the presumption. Contrary to CSBA's comments, the ability to rebut the presumption should not result in an undue burden that will require reallocation of a significant portion of the resources of small brewers. As Regulation 2559.1 provides, the manufacturer may submit a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The manufacturer has the choice to decide whether or not to rebut the presumption and the manufacturer has the actual knowledge of the content of the alcoholic beverage. This is a very minimal burden. Accordingly, no changes were made to the Regulations adopted by the Board.

- B. The Board and the Alcoholic Beverage Control Board will treat the same beers as something different.

Response

There is no prohibition against differing treatment. The Board has the authority to promulgate regulations for purposes of administering the Alcoholic Beverage Tax Law. See Response to 45-day Written Comment 3.C., above. The adopted Regulations clarify when an alcoholic beverage meets the definition of a "distilled spirit" or a "beer." Further, the adopted Regulations, taken as a whole, and in particular the safe harbor provision of Regulation 2559.5, *Correct Classification*, provide a bright line to assist taxpayers in properly reporting and paying taxes required to be administered by the Board. The compliance burdens associated with the adopted Regulations are minimal and these Regulations do not impact in any manner ABC's licensing responsibilities. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. The Board's actions will conflict with the beer standards enforced by the federal Alcohol and Tobacco Tax and Trade Bureau.

Response

The Board is not required to follow exactly federal law. Revenue and Taxation Code section 32152 provides that "the board [Board of Equalization] shall adopt such rules and Regulations as may be necessary to coordinate so far as permitted by the provisions of this part [the

California Alcoholic Beverage Tax Law] the system of beer and wine taxation imposed by this part with the system of beer and wine taxation imposed by the internal revenue laws of the United States.” Relevant to this issue, this section only applies to products that have been classified for purposes of tax assessment as either beer or wine. However, the Regulations adopted by the Board create a regulatory system to clarify what is classified as a “beer” and what is classified as “distilled spirits.” To the extent FMB would be classified as “distilled spirits” under these Regulations, Revenue and Taxation Code section 32152 would not apply to the taxation of FMB.

Even if, for argument’s sake, Revenue and Taxation Code section 32152 applied, the statute does not provide that the Board must follow exactly federal law. The statute provides only for “coordination,” when appropriate. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Additionally, California law is not the same as federal law. For example, under California law “sake” is specifically excluded from the definition of “beer.” (Bus. & Prof. Code, § 23006; Rev. & Tax. Code, § 32002.) In contrast, “sake” is specifically included in the definition of “beer” under federal law. (See 27 C.F.R. § 25.11 (2007).)

- D. CSBA objects to the Board’s proposed effective date of October 1, 2008, for the following reasons: (1) implementation raises a multitude of notice and response barriers that make it impossible for small brewers or the Board to meet an October 1, 2008, effective date; (2) California’s nearly 200 breweries lack the compliance infrastructure necessary to comply with an entirely new tax classification system; (3) not enough time exists to learn the presumption classification and how to file rebuttal reports; (4) it will take additional time to review products and prepare and submit rebuttal reports; (5) several more months, at least, of lead time before implementation are needed; and (6) the Board itself lacks infrastructure and experience.

Response

As to reasons (1), (2) and (4), contrary to CSBA’s comment, the compliance burdens associated with the adopted Regulations are minimal. Regulation 2559.1 allows a manufacture to rebut the presumption set forth in Regulation 2559 with respect to any alcoholic beverage by filing a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The statement under penalty of perjury mechanism for rebuttal was selected to ensure that only a minimal burden is placed on manufacturers seeking to rebut the presumption. Accordingly, the Board made no changes to the Regulations as a result of this comment.

As to reasons (3) and (5), an October 1, 2008, effective date for the presumption allows several months for preparation. The rebuttal process allows for the filing of a report under penalty of perjury, which specifies the sources and amount of the alcohol content of the subject beverage. The rebuttal process was selected to ensure only a minimal burden. Accordingly, the Board made no changes to the Regulations as a result of this comment.

As to reason (6), when the Regulations become effective the Board and its staff will administer them. Board staff has begun assessing and planning for the staff and other resources needed for the Board to be prepared for the effective date. The Board continues to maintain a page on its

Web site dedicated to this regulatory process and has begun collecting information related to the administration of the Regulations.⁴

Additionally, there is no statutory requirement that requires staffing and/or funding issues to be addressed in the Board's Hearing Notice and Initial Statement of Reasons. The Board is required to administer the Alcoholic Beverage Tax Law, which includes any and all regulations promulgated thereunder. If these Regulations are approved, the Board will effectively administer them under the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

E. CSBA incorporates by reference its previous submission. The previous submission is an undated letter, received on June 21, 2007, by the Board's Excise Taxes Division. In summary the letter sets forth the following comments:

- (1) The Regulations would require the reformulation or increase in taxation of California small brewer beer.

Response

The regulations do not require a reformulation. That is a decision to be made by a manufacturer and is not the subject of the Regulations. The tax rate imposed for "distilled spirits" is currently mandated by statute and is not being increased by the Regulations, nor could it. The Regulations are clarifying what products fall within the definition of "distilled spirits" in order for the Board to administer and enforce the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (2) The Regulations place an unfair risk on small brewers, who may face massive tax assessments and penalties due to an inadvertent failure to file the annual report called for in the proposed regulations.

Response

See Response to 15-day Comment 1.A. and 1. D.(1), (2) and (4), and Response to 45-day Written Comment 4.B., above. Additionally, possible "inadvertent" errors, while unfortunate, cannot prevent the Board from exercising its exclusive power to promulgate regulations to clarify the classification of alcoholic beverages for purposes of tax assessment and collection. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (3) The Regulations threaten the confidentiality of their members' beer recipes.

Response

See Response to 45-day Written Comment 3.G., above. Accordingly, no changes were made to the regulations adopted by the Board.

- (4) The Regulations disturb the national uniformity that helps California brewers.

⁴ See www.boe.ca.gov/sptaxprog/alcoholicbeverage.htm.

Response

See Response to 45-day Written Comment 4.D., and Response to 15-day Written Comment 1.C., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (5) The Regulations complicate an already complex regulatory scheme by suggesting that the same exact beer can be treated in very different ways by different state agencies.

Response

See Response to 15-day Written Comment 1.B., and 1.C., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (6) CSBA comments that the exemption of “wine” is “troubling.”

Response

See Response to 45-day Written Comment 4.B., and 5.C., above. Additionally, CSBA has provided no evidence or given any explanation for its statement. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Comment 2. Marc E. Sorini, Esq., Mc Dermott Will & Emory, on behalf of the Flavored Malt Beverage Coalition (Coalition)

In a letter dated April 4, 2008, written on behalf of the Coalition, Mr. Sorini wrote in opposition to the 15-day notice. In summary, Mr. Sorini set forth the following comments:

- A. Mr. Sorini states that the Coalition incorporates by reference its previously submitted comments.

Response

Responses to the Coalition’s previous responses are set forth above. See Response to 45-day Written Comment 3., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- B. The Board lacks the authority to interpret the Alcoholic Beverage Control Act in order to reclassify FMBs from beer to distilled spirits for the purpose of assessing and collecting excise taxes.

Response

See Response to 45-day Written Comments 3.C. and 7., above. Accordingly, no changes were made to the Regulations adopted by the Board.

- C. Article XX, Section 22 of the California Constitution does not empower the Board to adopt regulations defining the classifications of beer or distilled spirits that differ from those enforced by the ABC.

Response

See Response to 45-day Written Comments 3.C. and 7., above. There is nothing in California Constitution, Article XX, section 22 that prohibits this regulatory action. The Board has added Section 22 of Article XX of the California Constitution as authority for the Regulations merely for completeness. Section 22 of Article XX of the California Constitution provides the Board's exclusive underlying authority to assess and collect such excise taxes, as are or may be imposed by the Legislature, on account of the manufacture, importation and sale of alcoholic beverages in this State. Specifically, the California Constitution provides, in pertinent part, the following:

“The State Board of Equalization *shall assess* and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State.”

(Cal. Const., art. XX, § 22.)

Missing from Mr. Sorini's discussion is the specific language limiting the ABC's authority. Article XX, section 22 further provides, in pertinent part, that

“The Department of Alcoholic Beverage Control shall have the exclusive power, *except as herein provided* and in accordance with laws enacted by the Legislature, to license the manufacture, importation and sale of alcoholic beverages in this State” (Emphasis added.)

(Cal. Const., art. XX, § 22.)

The specific use of the phrase “except as herein provided” establishes that certain authority was not to be vested in the ABC. This “excepted” authority is later specifically given to the Board in Article XX, section 22. If these constitutional provisions were intended to somehow limit the Board's authority with respect to the assessing and collecting of tax, these provisions would have so provided. Instead, ABC's authority was specifically limited to give the Board exclusive authority over assessment and collection.

The Board was given the authority to assess and collect taxes as imposed by the Legislature. (Cal. Const., art. XX, § 22.) The Legislature has imposed such excise taxes as set forth in the Alcoholic Beverage Tax Law. (Rev. & Tax. Code, § 32001 et seq.) Further, Revenue and Taxation Code section 32451 specifically provides the Board general regulatory power to adopt

regulations relating to the Alcoholic Beverage Tax Law. In this regulatory action, the Board is clarifying the definition of “distilled spirits,” a defined term in the Alcoholic Beverage Tax Law. (Rev. & Tax. Code, § 32002; Bus. & Prof. Code, § 23005). Contrary to Mr. Sorini’s comment, the proposed regulatory action does not apply to or infringe in any manner on the ABC’s “exclusive power, except as herein provided and in accordance with the laws enacted by the Legislature, to *license* the manufacture, importation and sale of alcoholic beverages in this State.” (Cal. Const., art. XX, 22 (emphasis added).) The Regulations are for purposes of assessing and collecting taxes imposed by the Legislature under the Alcoholic Beverage Tax Law.

Accordingly, the Board made no changes to the Regulations as a result of this comment.

- D. “The Board does not have statutory authority to adopt regulations that redefine the classifications of beer and distilled spirits as governed by the Code.” Mr. Sorini comments that the plain meaning of Revenue and Taxation Code section 32002 does not authorize the Board to create its own alcoholic beverage classification.

Response

See Response to Written Comments 3.C. and 7., above. The Board is not creating its own alcoholic beverage classification. The Board is clarifying, under the definition of “distilled spirits” in the Alcoholic Beverage Tax Law, what alcoholic beverages fall under the classification of “distilled spirits.” The Board is utilizing the definition of “distilled spirits” as set forth in the Alcoholic Beverage Control Act and has determined that because FMB could potentially meet the statutory definition of either “beer” or “distilled spirits,” interpretive action by the Board is required to resolve ambiguity for taxpayers subject to the Alcoholic Beverage Tax Law.

The Board does not disagree that Revenue and Taxation Code section 32002 incorporates by reference the definitions set forth in the Alcoholic Beverage Control Act. Those definitions are now part of the Alcoholic Beverage Tax Law, the law the Board is required to administer. Accordingly, pursuant to its authority to promulgate regulations under the Alcoholic Beverage Tax Law (Rev. & Tax Code, § 32451), the Board has adopted the Regulations in order to clarify for purposes of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.”

Additionally, although the Board respectfully disagrees with certain aspects of the above discussed opinion of the Legislative Counsel of California (see 45-day Written Comment 2 and Response to 45-day Written Comment 2, above), the Legislative Counsel has opined that the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law, interpret the terms “distilled spirits,” “beer,” and “wine” as long as it is consistent with those terms as set forth in the relevant statutes and as validly interpreted by ABC. The Board’s adoption of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 is consistent with the relevant statutory language and is not contrary to any regulation promulgated by ABC.

Accordingly, the Board made no changes to the Regulations as a result of this comment.

- E. The Board mistakenly asserts that it has authority based on a prior statement by the ABC. Mr. Sorini comments that the Board’s position is “fundamentally deficient” for the following reasons:

(1) ABC's statement addresses neither the constitutional nor other statutory barriers; (2) the Legislative Counsel of California has determined that the Board "does not independently classify taxpayers or beverages for purposes of" the tax law; and (3) the Board itself has recognized the legal barriers to its actions.

Response

See Response to 45-day Written Comment 7.A., above.

As to reason (1), ABC's comment speaks for itself. The Board cannot address why ABC did not address any constitutional or other statutory barriers, other than to suspect it is because ABC does not perceive any such barriers.

As to reason (2), the Legislative Counsel has opined that the State Board of Equalization may, for purposes of the Alcoholic Beverage Tax Law, interpret the terms "distilled spirits," "beer," and "wine" as long as it is consistent with those terms as set forth in the relevant statutes and as validly interpreted by ABC. (See Response to 45-day Written Comment 2., above). The Board's adoption of Regulations 2558, 2559, 2559.1, 2559.3 and 2559.5 is consistent with the relevant statutory language and is not contrary to any regulation promulgated by ABC.

As to reason (3), with respect to the Board's brief filed in Support of its Demurrer to Complaint filed by County of Santa Clara and others, Case No. 506789, Mr. Sorini chooses select quotes to support his comments. The Board did state that ABC has "primary classification authority" over alcoholic beverages. That, however, does not mean that the Board concedes that ABC has exclusive classification authority. The Board also stated it has the "discretion" to defer to ABC's primary authority. (See Exhibit E to 15-day Written Comment 2, at p. 2.) Mr. Sorini, however, did not include this distinction with respect to the excerpt he quoted. Further, the Board stated "the statutory definitions for beer and distilled spirits require clarification and interpretation which are discretionary acts performed by administrative agencies *such as the Board.*" (*Id.* [emphasis added].) The Board is now exercising its discretion.

Accordingly, no changes were made to the Regulations based on this comment.

- F. “The Board can not propose regulations that are inconsistent with the plain language of the Code. . . . The Board’s addition of Code citations to the list of authority only exacerbates the proposed regulations’ fundamental conflict with the plain language of these statutes.”

Response

See Response to 45-day Written Comments 3.A. and 3.B, above. The Board added citations to the authority (Cal. Const., art. XX, § 22.) and reference sections (Bus. & Prof. Code, §§ 23004, 23005, 23006 and 23007) to the Regulations merely for completeness. The Board’s underlying authority stems from the California Constitution (see Cal. Const., art. XX, § 22) and is also set forth by statute (see Bus. & Prof. Code, § 23051.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- G. “Proposed Regulation 2558 redefines the term “distilled spirits” to include any beer that contains .5 percent or more of its alcohol content from non-beverage flavors or other ingredients containing distilled alcohol.”

Response

Regulation 2558 does not “redefine” the term “distilled spirits.” The final six words of the statutory definition of “distilled spirits” (i.e., “including all dilutions and mixtures thereof”) can be read to establish that whenever alcohol obtained from the distillation of fermented agricultural products is mixed, for beverage use, into an alcoholic beverage, the resulting beverage would, by definition, be classified as “distilled spirits” under California law. (Bus. & Prof. Code, § 23005.) Regulation 2558 clarifies that distilled spirits include an alcoholic beverage, except wine as defined by Business and Professions Code section 23007, which contains 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. The purpose of this regulation is to provide a bright line for when an alcoholic beverage is a “distilled spirit” under the Alcoholic Beverage Tax Law. Clarity is necessary because alcoholic beverages like FMB could potentially fall under both the definition of “beer” and “distilled spirits.” Accordingly, the Board made no changes to the Regulations as a result of this comment.

- H. The plain language of Business and Professions Code sections 23004, 23005, 23006 and 23007 do not support the regulatory action.

Response

The Board’s regulatory action is premised on its determination (see Introduction, at p. 2 and following, above) that the definition of “distilled spirits” requires clarification. (See Bus. & Prof. Code, § 23005). The plain language of the statute can be read to include FMB. Additionally, the definition of “beer,” could also include FMB. (See Bus. & Prof. Code, § 23006.) Therefore, because FMB could potentially meet the statutory definition of either “beer” or “distilled spirits,” interpretive action by the Board is required to resolve the ambiguity for taxpayers subject to the Alcoholic Beverage Tax Law.

Regulation 2558 clarifies that distilled spirits include an alcoholic beverage, except wine as defined by Business and Professions Code section 23007, which contains 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation

of fermented agricultural products. The purpose of this regulation is to provide a bright line for when an alcoholic beverage is a “distilled spirit” under the Alcoholic Beverage Tax Law. Clarity is necessary because alcoholic beverages like FMB could potentially fall under both the definition of “beer” and “distilled spirits.”

The 0.5 percent threshold was selected for two reasons. First, a bright line was needed to assist taxpayers in properly reporting and paying taxes. Therefore, since California law uses a 0.5 percent threshold to establish what beverage products contain a sufficient percentage of alcohol by volume to qualify as alcoholic beverages (See Bus. & Prof. Code, § 23004), if an alcoholic beverage contains 0.5 percent or more alcohol by volume obtained from the distillation of fermented agricultural products (whether added via flavors or other ingredients containing such alcohol, or otherwise), then that alcoholic beverage should be classified as a distilled spirit for taxation purposes. This standard allows for a de minimis or negligible amount of alcohol from distillation to be allowed in products obtained from fermentation as a result of adding a diminutive amount of flavorings and thereby preserves the definition of “beer” since the use of small amounts of alcohol-based flavorings (e.g., hops extract) can occur even in the manufacture of traditional beer products; but, at the same time, this standard recognizes that alcoholic beverages with the requisite amounts of alcohol from distillation meet the definition of “distilled spirits.” Second, the federal Alcohol and Tobacco Tax and Trade Bureau, during its rulemaking process addressing FMB, considered a 0.5 percent threshold. (70 Fed. Reg. 194 et seq. (January 3, 2005).) During the federal rulemaking process traditional beer companies indicated that their products were generally under this threshold.

Wine, as defined by Business and Professions Code section 23007, was excluded from the regulation because the definition of “wine” (Bus. & Prof. Code, § 23007) specifically allows for the inclusion of certain distilled products, if the added products are “distilled from the particular agricultural product or products of which the wine is made,” together with no more than “15 percent added flavoring, coloring, and blending material,” so long as the finished product “contains not more than 24 percent of alcohol by volume. . . .”⁵ Therefore, unlike the definition of “beer,” the statutory definition of “wine” specifically provides for certain mixtures or additions of alcohol obtained from distillation. Thus, in contrast to FMB, no similar clarification is required with respect to which products are within the definition of “wine.”

Regulation 2559 establishes a rebuttable presumption that alcoholic beverages, except wine as defined by Business and Professions Code section 23007, contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. This regulation is necessary in order to assist the Board with classifying products that meet the 0.5 percent threshold provided in Regulation 2558. In the interest of administrative feasibility, this regulation rebuttably presumes that alcoholic beverages contain 0.5 percent or more alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products. The Board understands that there are potentially thousands of alcoholic beverages which may meet the clarifying standard set forth in

⁵ “‘Wine’ means the product obtained from normal alcoholic fermentation of the juice of sound ripe grapes or other agricultural products . . . or any such alcoholic beverage to which is added grape brandy, fruit brandy, or spirits of wine, which is distilled from the particular agricultural product or products of which the wine is made . . . and which does not contain more than 15 percent added flavoring, coloring, and blending material and which contains not more than 24 percent of alcohol by volume” (Bus. & Prof. Code, § 23007 [emphasis added].)

Regulation 2558. Neither the Board nor the ABC possesses the necessary expertise to chemically analyze alcoholic beverages. Therefore, this presumption was utilized to place the burden of establishing which alcoholic beverages contain the requisite amount of alcohol from distillation on the parties with the actual knowledge of the contents of these beverages. This presumption also eliminates the undue delay and minimizes the administrative inefficiencies that would result from requiring the Board to analyze or review each alcoholic beverage sold in this state before tax could be properly assessed and collected.

Additionally, the Board has not cited Sections 23004 and 23005 as authority, but as reference sections for Regulation 2559.

Accordingly, the Board made no changes to the Regulations based on this comment.

- I. “The Board cannot propose regulations that are inconsistent with the ABC’s interpretation and application of the Code.

Response

See Response to 45-day Written Comments 2. and 7., above. The proposed Regulations are not contrary to any regulation promulgated by ABC. Mr. Sorini’s comments beg the ultimate issue. Without an FMB regulation promulgated by ABC, how is ABC interpreting the definitions of “beer” and “distilled spirits” when the plain language of the statutes does not provide clear direction for classifying, or even mention, FMB? Does ABC simply take what the manufacturer tells ABC at face value? Is ABC merely following the federal regulation and, if so, on what basis? In any case, notwithstanding ABC’s lack of regulatory action with regard to FMB under the Alcoholic Beverage Control Act, without the clarification provided by the adopted Regulations, taxpayers may report and pay incorrect amounts under the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- J. The Legislature expressly vested the ABC, not the Board, with sole authority to interpret the scope and meaning of the Alcoholic Beverage Control Act.

Response

The Board’s regulatory action does not apply to the Alcoholic Beverage Control Act. The Board is clarifying the definition of “distilled spirits” for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- K. “The stated effective date for the proposed regulations is unworkable for both the Board and the alcohol beverage industry.”

Response

The compliance burdens associated with the adopted Regulations are minimal. Regulation 2559.1 allows a manufacture to rebut the presumption set forth in Regulation 2559 with respect to any alcoholic beverage by filing a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The report under penalty of perjury

mechanism for rebuttal was selected to ensure that only a minimal burden is placed on manufacturers seeking to rebut the presumption. An October 1, 2008, effective date for the presumption allows several months for preparation. When the Regulations become effective the Board and its staff will effectively administer them. In the interim, Board staff has begun assessing and planning for the staff and other resources needed for the Board to be prepared for the effective date. There is also no statutory requirement that requires staffing and/or funding issues to be addressed in the Board's Hearing Notice and Initial Statement of Reasons. The Board is required to administer the Alcoholic Beverage Tax Law, which would include any and all regulations promulgated thereunder. If these Regulations are approved, the Board will effectively administer them under the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Comment 3. Gene Livingston, Esq., Greenberg Traurig, LLP, on behalf of Miller Brewing Company (Miller)

In comments dated April 7, 2008, written on behalf of Miller, Mr. Livingston wrote in opposition to the 15-day notice. In summary, Mr. Livingston set forth the following comments:

- A. The history of the Board's regulation of alcoholic beverages and the circumstances giving rise to the amendment of Section 22, Article XX negates any intent that the amendment was to confer authority on the BOE to classify alcoholic beverages.

Response

See Response to 45-day Written Comment 14.E. and Response to 15-day Written Comment 2.C., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- B. "The proposed definition of distilled spirits by implication results in a new definition of beer."

Response

See Written Response to 45-day Written Comments 3.A. and 3.B., above. The Board does not agree with this comment. The Regulations clarify which alcoholic beverages meet the definition of "distilled spirits" and do not provide a new definition of "beer." The statutory definition of "beer" remains. Accordingly, no changes were made to the Regulations based on this comment.

- C. "The proposed and implied definitions differ significantly and are inconsistent with the existing statutory definitions of distilled spirits and beer."

Response

See Response to 45-day Written Comments 3.A. and 3.B., above. Accordingly, no changes were made to the Regulations based on this comment.

- D. Mr. Livingston states that Miller provided comments to the Board on November 14, 2007, and incorporates them by reference into this comment.

Response

Responses to Miller's comments submitted November 14, 2007, are set forth above. See Response to 45-day Written Comment 14., above. Accordingly, no changes were made to the Regulations based on this comment.

- E. Section 22, Article XX of the California Constitution confers no authority on the BOE because of the following:

- (1) BOE's authority is limited to provisions of the Revenue and Taxation Code.

Response

This regulatory action does not apply to other than the Revenue and Taxation Code. The Board has adopted Regulations for purposes of administering the Alcoholic Beverage Tax Law. The definitions of "beer" and "distilled spirits," by statutory incorporation, are part of the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code, § 32002.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (2) Section 22, Article XX confers exclusive authority on the ABC to regulate alcoholic beverages.

Response

Section 22, Article XX confers ABC exclusive authority, "except as herein provided," to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes. (See Cal. Const., art. XX, § 22.) With the phrase "except as herein provided," the Legislature specifically carved out the Board's authority which is set forth later in Section 22. Specifically, the Board is required to "assess and collect such excise taxes as are or may be imposed by the Legislature." (*Id.*) Further, the Legislature enacted the Alcoholic Beverage Tax Law (see Rev. & Tax. Code, § 32001 et seq.) and gave the Board rulemaking authority under the same. (Rev. & Tax. Code, § 32451.) The Regulations clarify the definition of "distilled spirits" for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (3) Business and Professions Code Section 25750 evidences the Legislature's intent that only the ABC is authorized to adopt rules to implement Section 22, Article XX.

Response

Contrary to Miller's comment, the Regulations do not apply to Division 9 of the Business and Professions Code (the Alcoholic Beverage Control Act). Additionally, the Board does not disagree that Business and Professions Code section 25750 provides ABC regulatory powers for the Alcoholic Beverage Control Act and that ABC possesses other powers set forth in Article XX, section 22 of the Constitution. ABC's regulatory authority, however, does not negate the Board's authority to assess and collect taxes and adopt regulations relating to the

administration and enforcement of the Alcoholic Beverage Tax Law. (See Response to 45-day Written Comment 2., above) With the phrase “except as herein provided” in Article XX, section 22 of the Constitution, the Constitution specifically carved out from ABC’s authority the Board’s authority to assess and collect taxes. (See Cal. Const., art. XX, § 22.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (4) “Neither Part 14 of the Revenue and Taxation Code nor Division 9 of the Business and Professions Code contains any indication that the Legislature intended to confer dual jurisdiction on both the ABC and the BOE to enforce the provisions of the Business and Professions Code containing the definitions of ‘beer’ and ‘distilled spirits.’”

Response

Contrary to Miller’s comment, the Regulations have not been adopted to “enforce the provisions of the Business and Profession Code.” Pursuant to the Board’s authority to promulgate regulations under the Alcoholic Beverage Tax Law (Rev. & Tax. Code, § 32451), the Board has adopted the Regulations in order to clarify for the purposes of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.”

Additionally, Miller comments that a fundamental rule of statutory construction, *expressio unius est exclusivo alterius* (i.e., the expression of certain things in a statute necessarily involves the exclusion of other things not expressed) means that no other agency has the authority to make and prescribe regulations necessary and proper to administer the Alcohol Beverage Control Act. First, as stated above, the Regulations are adopted under the Alcoholic Beverage Tax Law in order to clarify for the purpose of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.” The Regulations do not apply to the Alcoholic Beverage Control Act. Second, contrary to Miller’s comment, the statutory language of Business and Professions Code section 25750 does not preclude the Board from adopting regulations for tax purposes, as the Board is authorized to do by Revenue and Taxation Code section 32451. (See Response to 45-day Written Comment 2., above.)

Business and Professions Code section 25750 simply provides ABC with general regulatory authority for the Alcoholic Beverage Control Act and any other authority conferred under the Article XX, section 22 of the Constitution, other than the authority specifically carved out of ABC’s authority and given to the Board. Specifically, the Constitution gives the Board authority to assess and collect taxes under the Alcoholic Beverage Tax Law. (See Cal. Const., art. XX, § 22.) Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (5) “Section 22, Article XX Confers Exclusive Authority on the ABC to Regulate Alcoholic Beverages.”

Response

See Response to Oral Comment 2.C., and Response to 15-day Written Comment 2.C., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- F. The BOE’s regulation of alcoholic beverages was corrupt, negating any intent in Section 22, Article XX to confer authority on it to classify Alcoholic Beverages.

Response

See Response to Oral Comment 2.C., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- G. “The Legislature In Business and Professions Code Section 25750 Evidences Its Intent That Only the ABC Is Authorized to Adopt Rules to Implement Section 22, Article XX.”

Response

To the extent Miller comments that the history behind the passage of Proposition 3 and/or the enactment of the Alcoholic Beverage Control Act has relevance to the Board’s authority to adopt the Regulations, see Response to Oral Comment 2.C., above.

Miller comments that Business and Profession Code section 25750 evidences the Legislature’s intent that the ABC implement the purposes of Article XX, section 22. The Board agrees that Business and Professions Code section 25750 provides ABC with regulatory authority to carry out the purposes and intent of Section 22 of Article XX of the California Constitution and the Alcoholic Beverage Control Act. The Board does not agree, however, that that the regulatory authority given to ABC somehow negates the Board’s specific authority in Section 22 of Article XX to assess and collect excise taxes as imposed by the Legislature. The Legislature has imposed those excise taxes in the Alcoholic Beverage Tax Law, wherein general regulatory power is given to the Board to administer and enforce the tax law. (See Rev. & Tax. Code, § 32451.) ABC was given regulatory authority to carry out the purposes and intent of Section 22 of Article XX as specified. Section 22, however, specifically, carves out of ABC’s authority through the use of the phrase “except as herein provided,” to provide the Board’s authority to assess and collect excise taxes as imposed by the Legislature on alcoholic beverages. (See Cal. Const., art. XX, § 22.) The Legislature has imposed such taxes under the Alcoholic Beverage Tax Law. The tax law then specifically provides the Board general regulatory authority to administer and enforce the tax law. (See Rev. & Tax. Code, § 32451.) The Board, therefore, disagrees with Miller’s comment and no changes were made to the Regulations based on the comment.

- H. Section 23049 of the Business and Professions Code further confirms that the Board is to tax in accordance with the classification of alcoholic beverages specified in the license through the structure of the Alcoholic Beverage Control Act.

Response

The Board does not agree with this comment. Business and Professions Code 23049 provides as follows:

“It is the intention of the Legislature in enacting this *chapter* to provide a governmental organization which will ensure a strict, honest, impartial, and uniform administration and enforcement of the liquor laws throughout the State.”

(Emphasis added.)

This section applies to the “chapter” which is Chapter 1.5. Administration of Division 9, the Alcoholic Beverage Control Act. This section does not apply to the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code, § 32001 et seq.) Additionally, the Alcoholic Beverage Tax Law and the Alcoholic Beverage Control Act are different statutory schemes with different purposes. The statutes are clear with respect to the Board’s general regulatory authority under the Alcoholic Beverage Tax Law. Additionally, the Legislature has not prohibited differences in classification for tax assessment and licensing purposes, respectively. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- I. The structure of the licensing/taxing interplay (see Rev. & Tax. Code, § 32101) confirms the Legislatures intent that BOE is to tax in accordance with the license issued by ABC.

Response

The Board disagrees with this comment. Section 32101 does not provide that the Board is to tax in accordance with the license issued by ABC. Section 32101 provides that the issuance of a license by ABC “shall constitute *registration* of the person to whom the license or permit is issued as a taxpayer...” (Emphasis added.) The plain language is “shall constitute registration.” The Regulations do not impact this section. The Board will continue to register the person as licensed by the ABC. The Regulations do not impact ABC’s authority to license the manufacture, importation and sale of alcoholic beverages in this State. The Regulations are for tax purposes only. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- J. “The BOE’s Regulation of Alcoholic Beverages Was Corrupt, Negating Any Intent In Section 22, Article XX to Confer Authority On it to Classify Alcoholic Beverages.”

Response

See Response to Oral Comment 2.C., above.

Miller comments that “nothing exists to infer that similar authority [to classify alcoholic beverages] was conferred on the BOE.” The Board does not agree. Section 22, Article XX of the Constitution specifically provides that that the Board “shall assess and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State.” The Legislature has imposed such excise taxes in the Alcoholic Beverage Tax Law. (See Rev. & Tax. Code, § 32001 et seq.) Revenue and Taxation Code section 32002 provides that the definitions in the Alcoholic Beverage Control Act are incorporated by reference and are to be utilized for purposes of the tax law. Further, Revenue and Taxation Code section 32451 provides the Board general regulatory power to administer and enforce the tax law. The Board has determined that because FMB could potentially meet the statutory definition of either “beer” or “distilled spirits,” interpretive action by the Board is required to resolve ambiguity for taxpayers subject to the Alcoholic Beverage Tax Law. Accordingly, pursuant to its authority to promulgate regulations under the Alcoholic Beverage Tax Law (Rev. & Tax. Code, § 32451), the Board has adopted the Regulations in order to clarify for the purpose of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.”

The Board made no changes to the Regulations as a result of this comment.

- K. Nothing in Section 22 or the legislation implementing it in either the Business and Professions Code or the Revenue and Taxation Code authorizes the BOE to subject certain alcoholic beverages to a different tax rate on its own.

Response

See Response to 15-day Written Comments 2.C., 3E., and 3.G., above. Additionally, the Regulations do not change the tax rates. The Regulations clarify when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.” Accordingly, the Board made no changes to the Regulations as a result of this comment.

- L. “The Proposed Regulation Defining Distilled Spirits Is Inconsistent with the Statutory Definitions of Distilled Spirits and Beer.”

Response

See Response to 45-day Written Comment 3.A., 3.B., and 3.N., above. Additionally, this comment does not address matters set forth in the 15-day Notice. Accordingly, the Board made no changes to the Regulations as a result of this comment.

Comment 4: Comments of the California Department of Alcoholic Beverage Control (ABC)

In a document dated April 4, 2008, ABC submitted comments to the 15-day notice. The following summarizes the comments:

- A. ABC incorporates by reference its previous comments submitted during the 45-day comment period.

Response

Responses to ABC’s comment dated November 14, 2007, are set forth above. See Response to 45-day Written Comment 7., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- B. ABC appears to be commenting, similar to other comments, that Article XX, Section 22 and Business and Profession Code section 25750 give ABC exclusive authority to implement the Constitution.

Response

See Response to 15-day Written Comments 2.C., 3.E., and 3.G., above. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- C. Despite the assertion that the proposed rules make classifications only for tax purposes, the distinction is not so clean and neat.

Response

How the Board classifies alcoholic beverages in no way impacts ABC's licensing. The Board does utilize ABC's licensing/permitting for registration purposes under the Alcoholic Beverage Tax Law, but that is for purposes of registration only. (See Rev. & Tax. Code, § 32101.) ABC will continue to determine what is a "beer," "distilled spirits," or "wine" for purposes of licensing.

D. ABC poses the following questions:

- (1) "Is the beer and wine importer who imports and pays taxes on FMB in violation of his license privileges by importing and possessing a 'distilled spirits'?"

Response

This is a question, not a comment with evidence or explanation. In any case, this would be ABC's determination under its exclusive authority to license and determine what is or is not a "distilled spirits" for purposes of licensing. The Regulations are only adopted for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (2) "Is a licensed beer manufacturer in violation of its federal permit or state license by producing 'distilled spirits?' See BPC § 23356."

Response

This is a question, not a comment with evidence or explanation. In any case, as to violations of state licensing law, this would be ABC's determination under its exclusive authority to license and determine what is or is not a "distilled spirits" for purposes of licensing. Similarly, the federal government would determine when violations of federal law have occurred. The Regulations are only adopted for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (3) "In order to protect its license and business, would a FMB producer be well advised to obtain a distilled spirits manufacturer's license? Should a business do that, it could have significant negative impacts on other business interests it might hold which could become prohibited under the Tied House Laws found at BPC §§ 2500 et seq." (Italic in original.)

Response

This is a question, not a comment with evidence or explanation. In any case, this would be under ABC's jurisdiction to advise an FMB producer under its exclusive authority to license and determine what is or is not a "distilled spirits" for purposes of licensing. The Regulations are only adopted for purposes of the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- (4) "Are FMB beer under the Revenue and Tax Code for purposes of employee consumption exempt from taxes as authorized pursuant to RTC § 32172?" "Would the Board consider

implementing a rule to treat them as beer [sic] § 32172 purposes but not for other tax purposes?”

Response

These are questions, not comments with evidence or explanation. In any case, whether or not any alcoholic beverage is a “beer,” “distilled spirits,” or “wine” for purposes of taxation is determined by the Alcoholic Beverage Tax Law and any effective regulations. Should the Regulations be approved, whether or not a particular FMB product is a “beer” or a “distilled spirit” will depend on whether or not the presumption of Regulation 2559 has been rebutted. Revenue and Taxation Code section 32172 would only apply to those alcoholic beverages that meet the definition of “beer,” under the Alcoholic Beverage Tax Law. Whether or not the Board would consider implementing a rule to treat FMB as beer under § 32172 is not the subject of this regulatory action and, if considered, would undoubtedly require a statutory change. Accordingly, the Board made no changes to the Regulations as a result of this comment.

- E. ABC continues to comment that the Regulations will cause confusion and that the final resolution should be made by the Legislature.

Response

See Response to 45-day Written Comment 3.H. and 4.C., above. There should be no confusion. The Regulations do not impact ABC’s licensing or federal licensing laws. Licensees licensed by ABC as “beer” licensees would not, as a result of these Regulations, lose a license, or be required to obtain a “distilled spirits” license.

While the Legislature, to the extent it believes the adopted Regulations fail to adequately clarify the distinctions between “beer” and “distilled spirits” for tax purposes, is certainly empowered to abrogate the adopted Regulations, the Legislature’s current inactivity does not prevent the Board from exercising its exclusive regulatory power in this area.

Accordingly, no changes were made to the Regulations adopted by the Board.

Received outside of comment periods

Comment 1. Mr. Mike Falasco, Director, California State Relations, Wine Institute

After the close of the 45-day comment period and before the 15-day notice, Mr. Falasco submitted the following letters on behalf of the Wine Institute:

March 7, 2008: Mr. Falasco confirmed the Wine Institute’s objection to the adoption of the proposed Regulations and submitted further comment. Specifically, Mr. Falasco commented that while the Wine Institute understands that the proposed Regulations are not intended to apply to wine, he requested further clarification of that intention.

March 17, 2008: Mr. Falasco withdrew the Wine Institute’s March 7, 2008, request for clarification that the proposed Regulations are not intended to apply to wine, and confirmed the Wine Institute’s continued opposition to the entire rulemaking.

For the sake of completeness, and because (1) comments preceding the 45-day comment period are included as part of the rulemaking record, as requested by Mr. Marc E. Sorini (see 45-day Written Comment 3.I. and Response to 45-day Written Comment 3.I., above) and (2) comments after the close of the 45-day comment period are also included (see, e.g., Written Comment 15 from the Honorable Bill Leonard, Member, Board of Equalization, Second District, above), Mr. Falasco's letters are also included in the rulemaking record at tab L.

Comments at the Board's April 8, 2008, meeting:

No public comments were received at the Board's April 8, 2008, meeting, at which the Board adopted the proposed Regulations following the 15-day comment period.