

UPDATED INFORMATIVE DIGEST

There has been no change in the laws relating to the proposed regulations, or the effect of the proposed regulations, from that stated in the Notice of Proposed Regulatory Action.

FINAL STATEMENT OF REASONS FOR
THE AMENDMENT OF REGULATION SECTION 25128
AND THE ADOPTION OF REGULATION SECTIONS
25128-1 AND 25128-2

The proposed regulatory action does not impose any mandate on local agencies or school districts.

UPDATE OF INITIAL STATEMENT OF REASONS

The public notice required by Section 11346.4 of the Government Code was mailed to the public and published in the *California Regulatory Notice Register* on October 9, 1998. The hearing was held, as scheduled, on November 23, 1998. One person gave oral testimony (Transcript of Hearing, Exhibit 11) and no written comments were received.

The Franchise Tax Board considered the proposed regulations at its December 16, 1998 meeting. The Board authorized the adoption of the regulations after the proposed nonsubstantial and sufficiently related changes were made available to the public. (Exhibit 12.)

As required by Government Code Section 11346.8(c) and Section 44 of Title 1 of the California Code of Regulations, a notice of the six nonsubstantial and sufficiently related changes was mailed to the public on February 3, 1999 with comments to be received until February 26, 1999. No written or oral comments were received during this period. However, two letters were received after the comment period ended (Exhibits 16 and 18). These letters were considered by the Franchise Tax Board at its March 23, 1999 meeting (Exhibit 20) and have been summarized and responded to below.

After the 15-day notice, two "Section 100" changes were made to Regulation Section 25128-1(g). The word "to" was added between the words "incidental" and "and" in paragraph 1, lines 8 and 12.

SUMMARY AND RESPONSE TO THE COMMENTS RECEIVED DURING THE ORIGINAL NOTICE PERIOD OF OCTOBER 8, 1998 THROUGH NOVEMBER 23, 1998.

COMMENT ONE:

Dave Doerr: (Hearing transcript – Exhibit 11, page 8)

The California Taxpayers' Association believes that public hearings should not be held in controlled-access facilities.

RESPONSE:

Regulation hearings conducted by the staff are held at the department's facilities as a matter of convenience to both the public and the department. The department saves money by not having to rent an outside facility, and it can also ensure that there is adequate, convenient parking for

members of the public. Staff conducting the hearings also have ready access to departmental records and to other staff whose knowledge or expertise might be needed during the hearing.

There is no rule of law that prohibits the department from conducting a regulation hearing at a controlled-access facility. Such a hearing conducted by an individual staff member is not subject to the open meeting laws, because it is not a “meeting” of the three-member Franchise Tax Board at which the Board itself could “take action.”

No change in the department’s practice is warranted.

COMMENT TWO:

Dave Doerr: (Hearing transcript – Exhibit 11, page 8)

The public notice that went out to the public indicated that if a request were received the three-member Board would hold a hearing. The changes in Board procedures adopted by the Board earlier this year indicated that the Board wanted to pass on all regulations. Thus, why is this statement included in the notice?

RESPONSE:

The statement was included to acknowledge the requirements of Government Code section 15702(b) in cases where a taxpayer requests in writing that the Franchise Tax Board itself act on a proposed regulation. With respect to these three proposed regulations, the Franchise Tax Board in fact held two different hearings for the purpose of giving directions to the staff regarding the substance of the proposed regulations. It also considered the proposed regulations at an additional meeting on December 16, 1998, at which it specifically authorized staff to proceed with final adoption of the proposed regulations after complying with the requirements of the Administrative Procedure Act, including giving notice to the public of the nonsubstantial and sufficiently related changes to the originally noticed proposed regulations.

No further action is necessary.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15-DAY NOTICE PERIOD OF FEBRUARY 4, 1999 THROUGH FEBRUARY 26, 1999.

No comments were received during this notice period.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED AFTER THE 15-DAY NOTICE PERIOD ENDING FEBRUARY 26, 1999.

COMMENT ONE:

ARCO (letter dated March 4, 1999, attached as Exhibit 16):

Example 1 added to regulation section 25128 should be amended to make it clear that gross receipts from qualified business activity include receipts from the sale of plastics if the plastics

are created from sequential processes performed on a crude substance on the premises of a refinery.

RESPONSE:

This comment was not submitted during the 15-day comment period. Therefore, it is rejected as untimely. In addition, the reasoning underlying the comment suggests that ARCO may be requesting a substantive change in the definition of ‘refining’ for purposes of the definition of extractive business activity. At its meeting on September 3, 1998, the Franchise Tax Board specifically approved language that confines "refining" to activities occurring “in a refinery” so as to avoid implicating the operations of chemical companies taking place in chemical plants, which are frequently located in close physical proximity to oil refineries. “In a refinery” is not synonymous with “on the premises of a refinery.” ARCO’s comment is, therefore, also rejected because adopting it would amount to a substantial change in the definition of extractive business activity contained in proposed regulation section 25128-1.

No change in the proposed regulations is warranted.

COMMENT 2:

ARCO (letter dated March 22, 1999, attached as Exhibit 18):

Example 1 in proposed regulation section 25128 is factually incomplete and misleading, and FTB staff improperly characterized it as a “non-substantive change.”

RESPONSE:

This example was part of the regulation package that staff sent to ARCO and other interested parties prior to its original consideration by the Franchise Tax Board at its meeting on August 6, 1998. The example was deleted from regulation 25128 at that meeting because the Board had not then decided on a definition of extractive business activity. The Board subsequently adopted a definition on September 3, 1998. On numerous occasions thereafter, the staff advised all interested parties, including ARCO, that it would recommend adding this example back into the regulation because it believed it to be consistent with the Board’s decisions at the September 3 meeting regarding the definition of extractive business activity. Although the staff on November 19, 1998, specifically asked that ARCO bring to staff’s attention any problems it had with this proposed course of action, ARCO did not raise any issue about it until its letter of March 4, 1999. ARCO was fully advised about staff’s proposed recommendation and knew that the Board intended to give final substantive approval to the proposed regulations at the last Board meeting of 1998. Thus, although ARCO could have objected to staff’s recommendation at any time, including at the regulation hearing on November 23, 1998, or at the Board meeting itself on December 16, 1998, it did not do so. ARCO’s failure to object until March 4, 1999, thus deprived the Board of the opportunity to address ARCO’s concerns before finally approving the proposed regulations on December 16, 1998.

No further action is necessary.

Alternatives Determined

The Franchise Tax Board has determined that no alternative would be more effective in carrying out the purposes for which the regulations are proposed or would be as effective and less burdensome to affected private persons than the proposed regulations.