

**State of California  
Office of Administrative Law**

**In re:**

**California Film Commission**

**Regulatory Action: Title 10  
California Code of Regulations**

**Adopt Sections: 5500, 5501, 5502,  
5503, 5504, 5505,  
5506, 5507**

**DECISION OF DISAPPROVAL OF  
REGULATORY ACTION**

**Government Code Section 11349.3**

**OAL File No. 2010-0203-01 C**

---

**DECISION SUMMARY**

On February 3, 2010, the California Film Commission (CFC) submitted to the Office of Administrative Law (OAL) the proposed adoption of sections 5500, 5501, 5502, 5503, 5504, 5505, 5506, and 5507 of Title 10 of the California Code of Regulations (CCR) regarding the California Film and Television Tax Credit Program (Program). The Program would establish the criteria and procedures for allocating tax credits to qualified taxpayers in the television and motion picture industry so as to encourage production of entertainment products within the State of California.

On March 18, 2010, OAL notified the CFC that OAL disapproved the proposed adopted regulations for failure to comply with specified standards of the California Administrative Procedure Act (APA). The reasons for the disapproval are summarized below:

A. the proposed regulation fails to comply with the clarity standard of Government Code sections 11349.1(a)(3) and 11349(c); and

B. the proposed regulation fails to comply with the consistency standard of Government Code sections 11349.1(a)(4) and 11349(d);

All APA issues must be resolved prior to OAL approval of any resubmission.

## BACKGROUND

In 2009, the Legislature enacted AB 15 (3<sup>rd</sup> Ex.Sess., c. 10) which allowed qualified taxpayers a credit against net tax for the production of qualified motion pictures in California. AB 15 also authorized the CFC to prescribe regulations to carry out the purposes of the measure.

The proposed regulations establish the tax credit application process, the content of the application, tax credit eligibility criteria, the kinds of expenditures that qualify for the credit, and the credit certificate issuance process, among other things.

CFC initially adopted these regulations as emergency regulations, effective May 29, 2009, pursuant to California Government Code Section 11346.1, so as to put the program into effect as soon as possible for production companies which were in the process of making shooting location decisions. Thereafter, the CFC gave Notice of Proposed Rulemaking to adopt the emergency regulations as permanent regulations on October 16, 2009, pursuant to California Government Code Section 11346.2. The CFC readopted the emergency regulations effective November 19, 2009, pursuant to California Government Code Section 11346.1.

On February 3, 2010, the CFC submitted the completed regular rulemaking file to OAL for review.

## DISCUSSION

Any regulation amended or adopted by a state agency through its exercise of quasi-legislative power delegated to it by statute to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly exempts the regulation from APA review. (Government Code sections 11340.5 and 11346.) OAL reviews regulatory actions for compliance with the standards for administrative regulations in Government Code section 11349.1.

Generally, to satisfy the standards, a regulation must be legally valid, supported by an adequate record, and easy to understand. In its review, OAL may not substitute its judgment for that of the rulemaking agency with regard to the substantive content of the regulation. OAL review is an independent executive branch check on the exercise of rulemaking powers by executive branch agencies and is intended to improve the quality of rules and regulations that implement, interpret and make specific statutory law, and to ensure that required procedures are followed in order to provide meaningful public opportunity to comment on rules and regulations before they become effective.

### A. CLARITY

In adopting the APA, the Legislature found that the language of many regulations was unclear and confusing to persons who must comply with the regulations. (Government Code section 11340(b).) Government Code section 11349.1(a)(3) requires that OAL review all regulations for compliance with the clarity standard. Government Code

section 11349(c) defines “clarity” to mean “...written or displayed so that the meaning of the regulations will be understood by those persons directly affected by them.” Title 1 CCR section 16 states in part that:

In examining a regulation for compliance with the ‘clarity’ requirement of Government Code section 11349.1, OAL shall apply the following standards and presumptions:

(a) A regulation shall be presumed not to comply with the ‘clarity’ standard if any of the following conditions exist:

(1) the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning; or

(2) the language of the regulation conflicts with the agency’s description of the effect of the regulation; ...

**Proposed Section 5506(a)(7).** Pursuant to proposed section 5506(a)(7), in order for a taxpayer to obtain a tax credit certificate, the taxpayer must submit, among other things, a Certified Public Accountant’s (CPA’s) report which complies with the provisions of a document entitled: “Agreed Upon Procedures.” Proposed section 5506(a)(7) incorporates by reference the “Agreed Upon Procedures” document into the regulations. Pursuant to Title 1 CCR Section 20, material incorporated by reference by a regulation must conform to the requirements of the APA. Subsection (b) of Section 20 provides as follows: “Material proposed for ‘incorporation by reference’ shall be reviewed in accordance with procedures and standards for a regulation published in the California Code of Regulations.” Material incorporated by reference, therefore, is reviewed for clarity and consistency and for compliance with all other standards established for regulations by the APA, even though it is not material that is published in the CCR.

On page 3 of the incorporated document, the CPA must obtain from the taxpayer “a listing from the production company of assets with a purchase price over \$10,000.” It is unclear from the language of this provision whether the listing must include all assets of the production company with a purchase price over \$10,000, or only those assets used in the motion picture production which is the subject of the tax credit application under review by the CPA. The potentially different interpretations of this provision may make a substantial difference in the burdensomeness of this requirement on production companies. As proposed, the text is not clear to persons auditing the expenditures for a motion picture production which assets would have to be shown on the listing.

## **B. CONSISTENCY**

Government Code section 11349.1(a)(4) requires that OAL review all regulations for compliance with the consistency standard. Government Code section 11349(d) defines “consistency” to mean “being in harmony with, and not in conflict with or contradictory

to, existing statutes, court decisions, or other provisions of law.” In this rulemaking, proposed section 5506(a)(7) conflicts with Government Code section 11340.5(a).

As described above, proposed section 5506(a)(7) incorporates by reference a document entitled: “Agreed Upon Procedures.” Page 3 of the incorporated document requires that the CPA, who is auditing the expenditures for a motion picture production which is the subject of a tax credit application, “[c]onfirm that the expenditure was allowable as defined by statute, CFC guidelines, Tracking Tips, and Qualified Expenditure Charts.” None of these documents is incorporated by reference by the “Agreed Upon Procedures” document, or by the text of the proposed regulations, and none was attached to the proposed text or included in the rulemaking file.

Government Code section 11340.5(a) provides:

No state agency shall issue, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in [Government Code] Section 11342.600, unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.

Proposed section 5506(a)(7) and the document incorporated by it require the application of auditing standards which are contained in CFC documents other than those being adopted by the CFC as a regulation and filed with the Secretary of State pursuant to the APA. The requirement that taxpayers’ motion picture production expenditures comply with these other standards constitutes rulemaking outside of the APA rulemaking process and is, therefore, inconsistent with Government Code section 11340.5(a).

### CONCLUSION

For the foregoing reasons, OAL disapproves the above-referenced rulemaking action. If you have any questions, please do not hesitate to contact me at (916) 323-4237.

Date: March 25, 2010



Dale Mentink  
Senior Staff Counsel

FOR: SUSAN LAPSLEY  
Director

Original: Amy Lemisch  
Copy: Terri Toohey