Case No. S241471

SUPREME COURT
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IN THE SUPREME COURT OF CALIFORNIA

Michael McClain, et al.,
Plaintiffs and Appellants,

v.

Sav-On Drugs, et al.,
Defendants and Respondents.

After a Decision of the Court of Appeal of the State of California,
Second Appellate District, Division 2
Appeal Nos. B265011 and B265029
Superior Court of Los Angeles County, Nos. BC327216 and BC325272,
John Shepard Wiley, Jr., Judge Presiding

APPLICATION TO FILE AMICUS CURIAE BRIEF AND PROPOSED BRIEF OF AMICI CURIAE ALINA BEKKERMAN, ET AL. IN SUPPORT OF PLAINTIFFS-APPELLANTS

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APPLICATION TO FILE AMICUS CURIAE BRIEF OF AMICI A. BEKKERMAN, B. GRIFFITH, J. LEE, AND C. LISSER IN SUPPORT OF PLAINTIFFS-APPELLANTS

Alina Bekkerman, Brandon Griffith, Jenny Lee, and Charles Lisser (collectively, "Bekkerman" or "Bekkerman Plaintiffs") are the named plaintiffs in a putative class action lawsuit entitled *Bekkerman v. California Department of Tax and Fee Administration,*[1] Sacramento Superior Court No. 34-2016-80002287, on appeal Third District Court of Appeal No. C085695, as well as a companion action, Sacramento Superior Court No. 34-2015-80002242, still pending.

The Bekkerman Plaintiffs' class action suit was brought against the Department as well as several retail sellers of mobile phones who are also carrier-service providers of mobile phone services. It alleges that the Department is illegally charging sales taxes on mobile phone sales based on non-existent phantom sales commissions. Those commissions are never actually paid on sales made in retail stores owned by mobile phone service

[1] The Taxpayer Transparency and Fairness Act of 2017 created the California Department of Tax and Fee Administration (CDTFA) and transferred to it most of the California Board of Equalization's tax-related duties, powers, and responsibilities. (Assem. Bill No. 102 (2017-2018 Reg. Sess.) § 1.) References to the "Board of Equalization" in the sales tax laws "shall be deemed to refer to the Department of Tax and Fee Administration." (Gov. Code § 15570.24(a).) For simplicity, this brief will refer to both the CDTFA and the Board as the "Department."

providers. Nonetheless, the Department assumes the commissions are paid and taxes accordingly.

In their suit, Plaintiffs have encountered the same arguments from the Department as made in the present action, i.e., that consumer payers of sales tax reimbursements based on illegally-imposed sales taxes are not entitled to refund remedies. They have advanced constitutional due process arguments similar to those advanced in the present action.

Based on their experience litigating against the Department in their own class action, the Bekkerman Plaintiffs are uniquely positioned to offer additional legal arguments and theories regarding the issues raised in the present action. Those arguments are included in the proposed Amicus Curiae Brief attached to this Application.

AUTHORSHIP AND FUNDING

No party or attorney in this litigation authored the proposed brief or any part of it. No one other than the Law Offices of Tony J. Tanke and Hattis Law have made any monetary contribution (or, indeed, any contribution) towards the preparation or submission of this brief. The brief was written entirely by counsel for the Bekkerman Plaintiffs in order to support Plaintiffs-Appellants in this action and to protect the Bekkerman Plaintiffs' interests in their own lawsuit.

For the foregoing reasons, the Bekkerman Plaintiffs respectfully request this Court's permission to file the attached Brief of Amici Curiae.

Dated: May 14, 2018

Respectfully submitted,

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BRIEF OF AMICI CURIAE ALINA BEKKERMAN, ET AL. IN SUPPORT OF PLAINTIFFS-APPELLANTS

INTRODUCTION

Taxation is vital to the efficient and effective operation of government. The law favors prompt collection of taxes to ensure the availability of public funds. But taxpayers have rights as well. They also have remedies when they are subjected to taxes that contravene the law. The system is kept in balance by a state constitutional provision prohibiting courts from enjoining tax collection pending litigation, but ensuring that, after payment of a tax claimed to be illegal, the payor can bring an action for a refund of the tax paid plus interest – according to procedures established by the Legislature. (Cal. Const., art. 13, § 32.)

The present case calls upon this Court to decide what happens when legislative procedures fall short in providing refund relief to one of the most numerous classes of California taxpayers – ordinary consumers who pay the lion's share of sales taxes imposed on hundreds of billions of dollars in sales. California sales taxation is defined by the complex character of tax statutes and regulations, the massive scale and diversity of millions of consumer transactions across our state, and persistent government efforts to increase the flow of public revenue into the state's coffers. On occasion, those efforts overreach and give rise to instances of illegal imposition and

collection of tax revenues. When this occurs, California taxpayers have constitutional due process rights to "clear and certain" judicial relief in the form of refunds of amounts illegally paid.

Our tax statutes do not provide clear and certain refund remedies to California consumers who are the economic taxpayers of illegal sales taxes. Instead, they expressly allow only retailers to claim refunds and to prosecute lawsuits to secure them. They do so even though statutes and regulations allow retailers to obtain reimbursement of all taxes paid by simply passing the amounts on to consumers as part of sales transactions. Consumers are accustomed to paying sales taxes and seeing them appear on sales slips and receipts. But they are not accustomed to illegal and unauthorized taxes on their purchases of goods and undoubtedly assume that all amounts they are charged as sales taxes are legitimately imposed.

Amici are consumers who were required to pay 100% of the sales taxes due on their purchases of mobile phone devices and mobile phone services in retail stores owned by the major mobile phone service providers. They are seeking refunds arising out of an illegal attempt by the state, acting through its Department of Tax and Fee Administration, to charge them sales taxes on non-existent sales commissions charged on their purchases. Those phantom commissions are not paid to anyone. They cannot be the basis of a sales tax. This happens because the major mobile phone service providers own their retail stores and do not pay themselves

sales commissions on their own sales. Amici, like other similarly situated consumer-taxpayers, are now confronting the Department's contention that they have no rights and no remedies at all that will secure to them what there are entitled to – *a refund of taxes illegally charged and collected.*

Amici will show below that they and other consumers are legally and equitably entitled to tax refund relief. They base their entitlement on the following propositions which are more fully discussed below:

- Consumers who pay sales tax reimbursements are legal taxpayers who should be accorded the rights of legal taxpayers in their dealings with the Department – especially when the Department has acted or is acting illegally in imposing and collecting tax.
- Consumer-taxpayers in California have due process rights to clear and certain remedies in the form of refunds of illegal taxes paid by them. They are also protected from takings of their property without compensation. Both sets of rights are violated by the Department's statutes and modes of operation.
- This Court has in the past made up for these statutory deficiencies in California law by establishing *equitable* judicial remedies by which consumer-taxpayers can compel their retailers to file tax refund claims with the Department and can compel the Department to insure that refunds are

given to those who actually paid illegal taxes. The Second District Court of Appeal in this case eviscerated these remedies by employing an erroneous interpretation of this Court's precedents. If its decision is upheld, California's system of sales taxation will be unconstitutional.

DISCUSSION

I. CONSUMERS WHO PAY SALES TAX REIMBURSEMENTS ARE LEGAL TAXPAYERS WHO SHOULD BE ACCORDED THE LEGAL RIGHTS OF TAXPAYERS.

The typical California retail sale that generates a sales tax is devoid of bargaining. It is a standard transaction with seller-dictated terms and prices. The consumer enters a sales establishment, selects an item for purchase, pays a stated price, and is given a sales receipt showing a charge to the consumer of the full amount of California sales tax attributable to the transaction. This typical retail sale was made in all of the transactions involved in the present action as well as all those involved in the actions referred to in the amicus briefs filed in support of Plaintiffs and Appellants.

Under California law, the sales tax is remitted to the Department by the retailer. The retailer files tax returns, forwards tax payments to the Department, and interacts with the Department about the taxes due. Because the law allows retailers to do so, they routinely pass 100% of the tax along to consumers. Consumers thus become the actual economic

taxpayers of all amounts paid in tax. While there are occasional exceptions (e.g., promotions where the seller offers to pay the tax itself), the standard approach is typical. The Department counts on it to obtain the funds California governments require to operate.

As amici will discuss, the law regarding the incidence of sales taxation is a morass. While state statutory and case law generally provide that the incidence of sales taxes falls on retail sellers, federal due process and other federal law is to the contrary. The simple reality is that consumers pay sales taxes; therefore, they alone have an incentive to challenge illegalities in the imposition and collection of those taxes. The Department's motivation to collect potentially illegal taxes – without opposition by the only affected parties – is supported and reinforced by the statutory tax refund remedies accorded only to retailers and not to consumers and economic taxpayers. This section will discuss the legal incidence of sales taxation in California; the next will explain the due process and takings consequences from the operation of the California sales tax scheme as envisioned, designed, and enforce by the Department.

A. The Legal Incidence of Sales Tax in California Falls On Consumers Who Routinely Reimburse Sellers For 100% of the Tax Paid.

For purposes of federal constitutional rights and legal protections, federal law determines the legal incidence of a tax. In California it places that incidence on the consumers who actually pay the tax.

In *Diamond Nat'l Corp. v. State Bd. of Equalization* (1976) 425 U.S. 268, ("*Diamond I*") the Supreme Court held that federal courts were not bound by either the California legislative or state court determinations as to where the legal incidence of a tax fell. (*Id.* at 268 (specifically referring to the California sales tax).) *Diamond I* held that the Department violated federal law by improperly imposing sales tax on a national bank. (*Id.*, citing *First Agricultural Nat'l Bank v. Tax Comm'n* (1968) 392 U.S. 339, 346-348.) "Because the question here is whether the tax affects federal immunity, it is clear that for this limited purpose, we are not bound by the state court's characterization of the tax." (*First Ag., supra*, 392 U.S. at p. 374.)

While *First Agricultural Nat'l Bank* addressed an issue of federal immunity, *Kern-Limerick, Inc. v. Scurlock* (1954) 347 U.S. 110 ("*Kern-Limerick*") had previously espoused a broader standard:

> "One might conclude this Court was saying that a state court might interpret its tax statute so as to throw tax liability where it chose...

Such a conclusion ... would deny the long [established] principle that the duty rests on this Court to decide for itself facts or constructions upon which federal constitutional issues rest." [2]

(*Id.* at p. 121-122 (emphasis added). *See also United States v. N.M.* (10th Cir. 1978) 581 F.2d 803, 806.

The Court conducted its own analysis and determined the legal incidence of excise tax was on the seller not the consumer), *aff'd.* (1982) 455 U.S. 720, 738; *United States v. Nevada Tax Com.* (9th Cir. 1971) 439 F.2d 435, 439-440 ("The constitutional question involved discriminatory application of [use tax] provisions" and its resolution depended on the interpretation of where the legal incidence of the tax fell, which "is a question of federal law upon which decisions of the states are not binding.")

In the 1930s, the California Legislature, this Court, and the federal district courts uniformly agreed that: California's sales tax imposed a fixed rate of tax on the retailer's gross receipts and not on the individual sale of merchandise, that the tax created a relationship between the State and the retailer and not between the State and the consumer, and that it did not matter that the retailer was required to pass the burden on to the consumer. (California Retail Sales Tax Act (Stats. 1933, ch. 1020, pp. 2599, 2600,

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[2] All emphasis is added unless otherwise stated.

2602 Stats. 1935, p. 1252); *Western Lithograph Co. v. State Bd. of Equalization* (1938) 11 Cal.2d 156, 161-163; *Meyer Const. Co. v. Corbett* (N.D.Cal. 1934) 7 F.Supp. 616, 617-618.)

From the outset, the courts have had trouble with the pass-through provisions the Legislature enacted, which stated, "**tax hereby imposed shall be collected by the retailer from the consumer in so far as it can be done.**" (California Retail Sales Tax Act (Stats. 1933, ch. 1010 § 8½), ("section 6052").) In *Roth Drug, Inc. v. Johnson* (1936) 13 Cal.App.2d 720, "shall" was interpreted to mean "to merely authorize the retail merchant to reimburse himself from the consumer in so far as it may be consistently done. He is not required to do so. He may waive that right." (*Id.* at 736.)

In *National Ice v. Pacific Fruit Express Co.* (1938) 11Cal.2d 283, this Court expressed concern about the constitutionality of the taxing scheme, particularly the pass-through requirement. (11 Cal.2d 283 at 291-292 (focusing on contract rights).) In *De Aryan v. Akers* (1939) 12 Cal.2d 781, this Court stated that section 6052 "charged the seller taxpayer with the ***mandatory duty*** to add the amount of the tax to his sales price, and to collect if from the purchaser along with the sales price" except for the limited cases where following that duty would infringe on the consumer's existing contractual *or other Constitutional rights.* (*Id.* at 786.) By 1949, this Court had adopted the *Roth* view of the incidence of retail sales taxes. (*See Ainsworth v. Bryant* (1949) 34 Cal.2d 465, 474 (comparing the

structure and requirements of California's Retail Tax to a San Francisco ordinance); see also *Pacific Coast Eng. Co. v. State of California* (1952) 111 Cal.App.2d 31 ("Since the tax is levied upon the retailer and his right of reimbursement is optional and may be waived by him, it follows, we think, that reimbursement of the amount of the tax rests upon the contractual agreement of the parties. The buyer-consumer has no obligation in reference to the tax. ... [E]ven though a contract is silent as to whether [the] price includes or excludes a sales tax, the law will not by implication add to the burden of the buyer.")

Subsequently, a series of U.S. Supreme Court cases began to scrutinize state taxing statutes as applied to banks. (See e.g., *Diamond I supra.*) The Court of Appeal in *Diamond Nat. Corp. v. State Bd. of Equalization* (1975) 49 Cal.App.3d 778 ("*Diamond II*") stated:

> "Unlike [recently invalidated schemes], this state has no mandatory requirement that its sales taxes be "passed on" to the purchaser. ... Section 6052 provides that '[the] tax hereby imposed shall be collected by the retailer from the consumer *in so far as it can be done*.' It is well settled that '[this] section *merely allows* a retailer to reimburse himself for payment of the tax. He is *limited* in doing so where the consumer's contractual or constitutional rights are infringed.' The retailer is *permitted* to pass the tax on to the consumer, but he is *not charged with a mandatory duty* to collect the

tax. Moreover, '[while] the act authorizes the retailer to collect the tax … that does not make it a consumer's tax.'" (*Id.* at 783 (original italics, internal citations omitted).)

In *Diamond I*, the U.S. Supreme Court reversed the Court of Appeal as applied to *federal issues.* (*Diamond I, supra,* 425 U.S. 268.) This Court almost immediately seized on that distinction:

> "The San Francisco tax ordinances before us contain no mandatory pass-on provisions, and it is equally clear that the mere ability to recoup the loss by raising prices will not necessarily shift the legal incidence of the tax. … *Diamond Nat. Corp. v. State Bd. of Equalization* (1975) 49 Cal.App.3d 778 [123 Cal.Rptr. 160], revd. on issue of fed. immunity; 425 U.S. 268." (*Western States Bankcard Assn. v. San Francisco* (1977) 19 Cal.3d 208, 217.)

Despite this Court's observation just quoted in *Western States*, the California Legislature repealed the mandatory reimbursement requirement of section 6052 and replaced it with Civil Code section 1656.1, which created a presumptive contract between the retailer and the consumer for sales tax reimbursement. (Stats. 1978, Ch. 1211.) Since then, California courts are still guided by this principle:

> "Under California's sales tax law, the taxpayer is the retailer, not the consumer. … As for the interests of consumers, … retailer/taxpayers are permitted, but not required, to contract with consumers to charge

a reimbursement amount to reimburse the retailer for its own payment of sales tax on a transaction. Alternatively, the retailer may choose simply to absorb the tax."

(*Loeffler v. Target Corp.* (2014) 58 Cal.4th 1081, 1103; See also, e.g., *GMRI, Inc. v. CDTFA* (2018) 21 Cal.App.5th 111, 118 (retailer is taxpayer).)

However, even some members of this Court appear to have trouble with this idea. "The City is correct to focus on the … legal incidence, but its argument fails because, under the Ordinance, both the legal incidence and the economic burden … fall on [the] consumers… The rule in California is that where the government *mandates* payment of a charge by one party and imposes a duty on some other party to collect that payment and remit it to the government, the legal incidence of the charge falls, not on the party collecting the payment—who acts merely as the governments collection agent or conduit—but on the party from whom the payment is, by law, collected." (*Jacks v. Santa Barbara* (2017) 3 Cal.5th 248, 279 (dis. opn. of Chin, J.) While we agree with Justice Chin that this should be the case, it is also worth noting that throughout most of the history of the sales tax in California, the courts have had to force the word "shall" to mean "may" in order to prevent the existence of such a mandate.

California claims that its sales tax is placed upon the retailer and that the consumer is not the taxpayer. Yet fiscal reality shows that this is a convenient fabrication. Section 6012 states, in part,

> "For the purposes of the sales tax, if the retailers establish to the satisfaction of the Board that the sales tax has been added to the total amount of the sales price and has not been absorbed by them, the total amount of the sale price shall be deemed to be the amount received *exclusive of the tax imposed.* Section 1656.1 of the Civil Code shall apply in determining whether or not the retailers have absorbed the sales tax."

In 2016, taxable sales within the State of California exceeded $649 billion. (Taxable Sales in California 2016, Table 1: Statewide Taxable Sales, By Type of Business, California Board of Equalization, https://www.boe.ca.gov/news/tsalescont16.htm, last accessed Apr. 29, 2018.) If all retailers did not charge sales-tax reimbursement and the statewide tax rate of 7.25% were assumed to be charged, California *retailers* would lose over $47 billion in revenue.[3] **Access to more than an**

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[3] The actual loss could be substantially higher. As an example, consider a retailer that has gross receipts of $1,000,000 in the City of Commerce, which has a 10.000% sales tax rate. (*See* California City & County Sales & Use Tax Rates, *supra.*) If the retailer charges sales tax reimbursement on the consumers, the retailer will have an additional $100,000 of receipts upon which the retailer will not owe sales tax. Thus, after paying the sales tax, the retailer would have $1,000,000 net. If, however, the retailer does not charge sales tax reimbursement on its consumers, the retailer would

additional $47 billion is an incredibly powerful incentive for California businesses to seek sales-tax reimbursements from all their customers.

This powerful incentive for retailers challenges the *presumption* that consumers consent to pay sales tax reimbursement and are not the actual taxpayers. Amici urge this Court to recognize that $47 billion per year is a sufficient "foot on the scale" to make California's "may" obtain reimbursement into "shall" and to follow the federal courts' view that the consumers are the taxpayers. That view will now be explored.

In *United States v. California State Bd. of Equalization* (9th Cir. 1981) 650 F.2d 1127 ("*US v. BOE*"), *affd* 456 U.S. 901 (1982), the Ninth Circuit determined that, when looking at California's sales tax statutory scheme as a whole, the legal incidence fell on the consumer and not on the retailer. With respect to resolving federal constitutional issues, the Ninth Circuit stated: "In determining who the legislature intends will pay the tax, the entire state taxation scheme and the context in which it operates as well as the express wording of the taxing statute must be considered." (*Id.* at 1131.) As the Supreme Court has observed, "determining whether a tax is actually laid on the [consumer] [requires going] beyond the bare face of the

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owe $100,000 of the $1,000,000, leaving the retailer with only $900,000 net. That retailer has a $100,000 incentive to pass the tax burden on to the consumer instead of the $72,500 incentive it would have paying just the California state tax. For retailers typically working with 1-3% profit margins, this is significant.

taxing statute to consider all relevant circumstances." (*U.S. v. City of Detroit*, 355 U.S. 466, 469 (1958).)

In *US v. BOE*, the particular taxed transactions were between lessors and lessees. However, the same analysis applies when sales tax transactions100% and the relationship of retailers and consumers are at stake:

> The California sales tax scheme ... is unlike statutes struck down in previous cases because *it is facially neutral* as to who is to pay the sales tax. ... [T]he presumptions set forth in [Cal. Civ. Code § 1656.1 (a) and (b)] do not appear to be a subtle legislative attempt to require the seller to pass the tax on to the buyer. ¶ ***The seeming neutrality of section 1656.1 is rendered illusory, however, by the interaction of California Revenue and Taxation Code sections 6012 and 6051.*** ... If the lessor requires the lessee to pay the tax, the amount of the tax is deducted from the lessor's gross receipts. If the lessor pays the tax himself[,] absorbs the tax and passes the economic burden of the tax on to the lessee as an increase in the lease price, the amount of tax paid by the lessor is not deducted from his gross receipts. Since the sales tax is levied on the basis of the lessor gross receipts, the lessor must remit a *larger sum of money to the state as taxes if he absorbs the*

> *tax himself than if he collects the tax from the lessee.* Therefore, the lessor maximizes his profit *only if he separately states and collects the tax from the lessee...* ¶ Despite the facial neutrality of Section 1656.1, *the strong economic incentive created by Section 6012* ***all but compels the lessor to collect the tax from the lessee. In sum, the California sales tax scheme manifests a legislative intent that the lessee pay the sales tax.***"

(*US v. BOE, supra*, 650 F.2d at 1131-1132).

The Supreme Court summarily affirmed the *US v. BOE* decision without comment. (*Bd. of Equalization v. U.S.* (1982) 456 U.S. 901.) The significance of the summary affirmance is readily apparent. The only way the Supreme Court could have upheld the Ninth Circuit's ruling was by accepting the premise that the California sales tax scheme placed the legal incidence on the lessee/consumer. The High Court's decision in *U.S. v. Tax Comm'n of Miss.* (1975) 421 U.S. 599 throws additional light on the matter. Discussing why the *legal incidence* of an alcohol tax fell on the consumer and not the vendor, the Court there observed:

> We cannot accept the reasoning of the court below that simply because there is no sanction against a vendor who refuses to pass on the tax (assuming this is true), this means the tax is on the vendor. ... Finally, even in the absence of

> this clear statement of the Tax Commission's intentions, the obvious economic realities compelled the distillers to pass on the economic burden of the markup."

(*Id.* at 609 and fn.8.) Thus, if the economic realities imposed by the state *compel* the retailers to pass on the tax, the legal incidence of the tax falls to the consumers.

In *Coeur D'Alene Tribe v. Hammond* (9th Cir. 2004) 384 F.3d 674 ("*Hammond*"), the court reaffirmed and expanded this idea: The incidence of a sales tax on a sovereign Indian nation is inescapably a question of federal law that cannot be resolved by the state legislature's mere statement. (*Id.* at p. 682-683.) Specifically, permitting a state legislature hide its "*intent* about where the incidence of the tax lies … merely be reciting *ipso facto* that the incidence of the tax falls upon another party" would undermine Supreme Court precedent and "permit states to set policy in a way that risks undermining" *federal questions of law*. (*Id* at 683 (original emphasis).) "[L]egislative declaration … cannot be viewed as entirely 'dispositive' of the legal issue that the federal courts are charged with determining as to the incidence of the tax. And this is not merely a technical tax issue." (*Id.* at 684.) While federal courts give great deference to a state court's definitive determination of the operating incidence of a tax, it will only be deemed conclusive where it is consistent with the statutory scheme's "reasonable interpretation." (*Ibid.*)