S241471

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

MICHAEL McCLAIN, et. al.,
Plaintiffs, Appellants and Petitioners,

v.

SAV-ON DRUGS, et. al.,
Defendants and Respondents.

Review of a Published Decision of the
Second Appellate District, Case Nos. B265011 and B265029
Affirming a Judgment of Dismissal Following
An Order Sustaining a Demurrer Without Leave to Amend

On Appeal from the Superior Court of the County of Los Angeles
The Honorable John Shepard Wiley, Judge
Case Nos. BC325272 and BC327216

HOWARD JARVIS TAXPAYERS ASSOCIATION'S APPLICATION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE IN SUPPORT OF APPELLANTS

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Howard Jarvis Taxpayers Association ("HJTA") is a California nonprofit public benefit corporation with over 200,000 members. The late Howard Jarvis, founder of HJTA, utilized the People's reserved power of initiative to sponsor Proposition 13 in 1978. Proposition 13 was overwhelmingly approved by California voters, and added Article XIIIA to the California Constitution. By limiting the rate and annual escalation of property taxes, Proposition 13 has made it affordable for millions of fixed-income Californians to continue living in their own homes. In this case, HJTA feels concerned about the affordability of another essential aspect of life - medical care.

In 1996, HJTA authored and sponsored Proposition 218, the Right to Vote on Taxes Act. California voters passed Proposition 218, which added Articles XIIIC and XIIID to the California Constitution and placed strict limitations on local governmental entities' authority to levy taxes, fees, and charges for property-related services. HJTA also participated in the drafting process of Proposition 26 which, in 2010, amended Articles XIIIA and XIIIC to expand and simplify the definition of a "tax."

Because HJTA is routinely in court enforcing Propositions 13, 218, and 26, HJTA has a vested interest in the determination of basic rights and remedies essential to all taxpayer litigation. The functioning of the "pay first, litigate later" rule of Article 13 section 32 of the California Constitution, along with the deference to the legislative branch as the general authority on tax refund procedures, is of regular interest to HJTA. While the rule serves the purpose of ensuring stable government revenues, this case reaches its outer limits. In this case, HJTA is deeply concerned that the true taxpayer does "pay first," but has *no option* to "litigate later."

On the general merits of this case, HJTA supports Plaintiffs and Appellants and encourages this Court to overturn the decision of the Second District, Division Two, Court of Appeal. HJTA requests leave from this Court to file the accompanying Brief of Amicus Curiae in order to lend its expertise and perspective as taxpayer advocates.

AUTHORSHIP AND FUNDING

No party or attorney to this litigation authored the proposed amicus brief or any part thereof. No one other than HJTA made a monetary contribution toward the preparation or

submission of the brief.

For the foregoing reasons, HJTA respectfully requests this Court's permission to file the attached Brief of Amicus Curiae.

Dated: April 12, 2018

Respectfully submitted,

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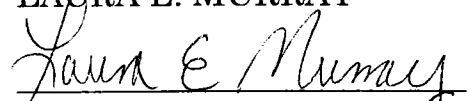

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BRIEF OF AMICUS CURIAE

INTRODUCTION

California's Statutory **Myth**: The legal incidence of sales tax is on the retailer. (Rev. & Tax. Code, § 6051; *McClain v. Sav-on Drugs ("McClain")*(2017) 9 Cal.App.5th 684, 698, 705 [admitting the consumer is the "economic taxpayer" who has the obligation to pay, "but not the right to seek a refund," while the vendor is the "legal taxpayer"].)

Constitutional, Functional and Statutory **Reality**: The purchaser is the taxpayer. (Rev. & Tax. Code, § 6012[1]; *National Ice & Cold Storage Co. of California v. Pacific Fruit Express Co. ("National Ice")*(1938) 11 Cal.2d 283, 292 [Regarding the original statute wherein "tax hereby imposed shall be collected by the

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[1]Amicus refers to the last sentence of this section which explains that if the retailer "absorbs" the "sales tax" paid by the customer, the retailer's taxable gross receipts are deemed to equal the total amount charged to the customer without any credit for the tax. In other words, the retailer would then pay tax on the sales price *plus* the "sales tax," so that the tax the retailer would pay is now slightly more than what the customer would have thought he had paid in "sales tax." (See *Loeffler v. Target Corp.* (2014) 58 Cal. 4th 1081, 1109.) Thus, if the retailer were the true taxpayer, the amount the retailer would pay would be a different and slightly greater amount. What the customer would pay would simply be a higher actual sales price which results in *almost* compensating the retailer. **Unless, in the rare instance, the retailer "absorbs" the tax which then creates a different "amount" of tax, the retailer is nothing more than a pass-through device of the real tax paid by the customer**. (See *National Ice, supra*, 11 Cal.2d at pp. 290;292.) That the "amount" of tax (See Rev. & Tax. Code, §§ 6931-6937) is different depending on whether it was paid by the customer as "sales tax reimbursement" or by the retailer as "absorbed" demonstrates that the customer is the real taxpayer when paying what we have termed in California "sales tax reimbursement."

retailer from the consumer in so far as the same can be done" and which could not be "absorbed," the Court held that allowing the retailer to force the purchaser to pay the retailer's tax debt is unconstitutional, but allowing the "retailer to 'pass on' the tax to a purchaser with the latter's consent thereto" is acceptable.]; Civ. Code, § 1656.1; *Diamond National Corp. v. State Bd. of Equalization* (*"Diamond National"*)(1976) 425 U.S. 268 ["We are not bound by the California court's contrary conclusion and hold that the incidence of the state and local sales taxes falls upon the national bank as purchaser and not upon the vendors."].)

Grappling with the statutory myth, the Court of Appeal in *McClain* rests its decision on a little-bit-pregnant foundation of purchasers as "economic taxpayers," but not legal taxpayers. (*McClain, supra,* 9 Cal.App.5th at pp. 698; 705.) Yet, the United States Supreme Court had held in *Diamond National* that the purchaser is the real taxpayer. (425 U.S. 268.) This court in *National Ice* likewise had acknowledged that the tax is "pass[ed] on" to the customer. (11 Cal.2d at pp. 290; 292.) Does the tax's nature truly change once "passed on"? This Court declared:

> [T]o baldly legislate that without, and in absence of either due *or any* process of law, a legal debt that is owed by one person must be paid by another, is quite

> at variance with ordinary notions of that which may be termed the administration of justice.
> (11 Cal.2d at p. 291, emphasis added.)

There is neither due nor "any process of law" available here to the diabetic customers who have paid the sales tax for eighteen years.

As interpreted by the California cases, which have enforced both Revenue & Taxation Code section 6051 (denying customers a remedy against the State on the theory that the seller, not the customer, is the taxpayer) and section 6012 (denying customers a remedy against the seller on the theory that the tax was due and the customer agreed to reimburse the seller at the point of sale), the tax code is in irreconcilable conflict with Civil Code section 3523, which promises that "[f]or every wrong there is a remedy." (See also Title 3 Interpretation of Contracts, Civ. Code, §§ 1636-1663.) This conflict results in constitutional and procedural deprivations to the true taxpayer recognized by this Court in *National Ice* and by the United States Supreme Court in *Diamond National.*

QUESTIONS PRESENTED

The issue as summarized by this Court is: "Can a purchaser of products allegedly exempt from sales tax but for which the retailer collected sales tax reimbursement bring an action to

compel the retailer to seek a sales tax refund from the State Board of Equalization and remit the proceeds to purchasers?"

Specifically, the issues are: 1) Is *McClain* inconsistent with this Court's holdings in *National Ice & Cold Storage Co. v. Pacific Fruit Express Co.* (*"National Ice"*)(1938) 11 Cal.2d 283, *Javor v. State Equalization Bd.* (*"Javor"*)(1974) 12 Cal.3d 790, and *Loeffler v. Target Corp.* (*"Loeffler"*)(2014) 58 Cal.4th 108?, and 2) Is it possible to harmonize Civil Code section 1656.1 with the tax code without harming the diabetic consumers' constitutional or procedural rights?

ARGUMENTS

I. As Prophesied by the *Diamond National* Dissent, the *McClain* Court of Appeal Has Imposed a Legal Obligation on the Purchaser To Pay the Tax or To Reimburse the Vendor.

The dissent in *Diamond National* declared that "it is only if the State imposes a legal obligation on the purchaser either to pay the tax, or to reimburse the vendor for a tax payment, that the legal incidence is on the purchaser." (*Diamond National, supra*, 425 U.S. at p. 270 (dis. opn. of Stevens, J.).) Even that has now occurred. Purchasers no longer have an effective opportunity to rebut the presumption of their agreement to pay the sales tax

reimbursement. (See Civ. Code, § 1656.1(d).) In the Court of Appeal's own words, the customer has but "the practical equivalent of allowing them to tug (albeit persistently) at the Board's sleeve." (*McClain, supra,* 9 Cal.App.5th at p. 706.) Civil Code section 1656.1(d) is now meaningless.

The purchaser is the real taxpayer under the majority opinion of *Diamond National* which clearly acknowledges that "the incidence of the state and local sales taxes falls upon the national bank as purchaser and not upon the vendors." (425 U.S. at p. 268.) Following the literal California statute declaring the retailer the taxpayer, the *McClain* Court of Appeal now obligates the purchaser to pay the tax or reimburse the vendor. Thus, even applying the *Diamond National* dissent, the purchaser should have standing in a refund action because the legal incidence of taxation is squarely upon him.

McClain rests on the premise that the customer will have no rights *unless* the Department of Tax and Fee Administration ("CDTFA") determines that the glucose test trips and lancets are exempt from sales tax. (9 Cal.App.5th at p. 690.) Such absolute power is inimical to due process of law because the CDTFA could choose never to make or finalize that determination. In this case,

the regulation has been operative since March 10, 2000. (Cal. Code Regs., tit. 18, § 1591.1.) The CDTFA has yet to make any determination. (See Resp. CDTFA's ABM at p. 34.) Governor Gray Davis vetoed legislation to create an express statutory exemption under the stated impression that diabetics are already exempt, presumably per the regulation. (See Resp. CDTFA's ABM at pp. 42-43.)

The Court of Appeal in *McClain* claims there is no due process problem because there is no state action. (9 Cal.App.5th at pp. 704; 706.) However, either the State is acting against the customer to collect tax from him as the true taxpayer with no recourse or the State is acting against the customer by setting up a permanent escheat of the customer's funds with no recourse because of the retailer's safe harbor. (Rev. & Tax. Code, § 6901.5.) Either way, there is a due process problem, or, at minimum, a "process of law" deprivation. (*National Ice, supra*, 11 Cal.2d at p. 291.) If the money is not a tax, there is additionally a takings problem.

First, not only may the Court reject California's statutory definition of the retailer as the true taxpayer (see Resp. CDTFA's ABM at p. 47), but it must. Where due process is now non-

existent for the true taxpayers, the United States Supreme Court holding in *Diamond National*, where the dissent would concur, must control. No further analysis or argument is necessary.

Second, none of the remedies suggested by CDTFA guarantee any meaningful opportunity for hearing and review. Petitioning to amend or repeal the regulation would only delay matters, not resolve them. Since there is no guarantee that the petition would be granted or even acted upon, a petition to amend or repeal the regulation is not a remedy. Shifting responsibility to diabetics to try to harmonize the law when they themselves have no law-making power is also an unreasonable hurdle to due process. If CDTFA concedes that the regulation is in need of amendment or repeal, then there is no reason to delay action until diabetics first file a petition. However, amicus submits that the regulation does not need to be amended. It already permits a remedy. Not only should amendments be unnecessary, but there would remain the same lack of guarantee that any amendment would be enforced. (See Resp. CDTFA's ABM at pp. 41-42.) Further, while describing how diabetics should be able to influence the regulations, Respondents state *no* mechanism for customers to have a chance at *refunds*. Similarly, the suggested

use of Government Code section 11350(b)(1) is misdirected and inadequate. (See Resp. CDTFA's ABM at p. 42.) Section 11350(b)(1) serves to invalidate a regulation. The customers do not need to invalidate the regulation, but to enforce it. Declaratory relief, if there were a valid mechanism, might be appropriate if diabetics did not need to purchase their supplies for daily use and if their health could afford to litigate the issue quickly before taking part in any taxable event. Unfortunately, "[w]hen the taxpayer has completed a transaction, resort to declaratory relief is no longer necessary or appropriate since the tax liability, if any, has accrued and therefore normal administrative processes, subject to judicial review, are adequate and accomplish the same result." (*Honeywell, Inc. v. State Board of Equalization* (1975) 48 Cal.App.3d 907, 912). The customer here *would* resort to the administrative process of filing a claim for refund, but we return to the statutory myth that the customer is not the legal taxpayer and thus cannot file one.

California's statutory scheme treating the vendor as the taxpayer is a troublesome myth. After the *McClain* decision, the California Supreme Court decision in *National Ice* and the U.S. Supreme Court decision in *Diamond National* (*and* its dissent)

are violated.

II. Diabetic Consumers' Access To Medical Supplies Is Effectively Conditioned Upon Forfeiting Constitutional and Procedural Rights At Point of Sale.

HJTA will refrain from briefing the effects of the presumptions established under Regulation 1591.1(b)(5) of the California Code of Regulations exempting glucose test strips and lancets from tax. This has been thoroughly addressed by Petitioners. (See Petitioners' AOB, at pp. 14-16.) In short, it is established and obvious that no one would buy glucose test trips and lancets if not for medical purposes, and that physician supervision is presumed. (*Ibid.*) As the Board itself declared in its "Final Statement of Reasons" when adopting the regulation, it had itself calculated the regulation to result in a 100% loss of tax:

> [T]hese items are so integrated with the operation of insulin and insulin syringes (the syringes cannot be used until the patient has first tested his blood sugar using the lancets and strips) that the Legislature intended that their sales be exempt from tax as part and parcel of the exemption for sales of insulin syringes under [Rev. & Tax. Code] section 6369(e).

(*Id.* at p. 16, citing AA 200; 068-071 ¶¶24-27(b).)

Respondent CDTFA offers that a consumer "may choose to purchase the item from a retailer that takes a more liberal view of the exemption." (Resp. CDTFA Answer Brief, at p. 40.) Not

only would this require a greater amount of time than a diabetic will have to make her purchase without imperiling her health, but this suggestion would vest judicial and administrative authority in retailers to make inconsistent conclusions of law[2]. Diabetics should not have to shop for different laypersons' interpretation of law.

A government agency violates the unconstitutional conditions doctrine by "pressuring someone into forfeiting a constitutional right" by "coercively withholding benefits." (*Koontz v. St. Johns River Water Mgmt. Dist.* (*"Koontz"*)(2013) 570 U.S. 595, 133 S.Ct. 2586, 2595.) Healthcare benefits are recognized direct objects of the unconstitutional conditions doctrine. (*Ibid.*) The benefits of the sales tax exemption are essentially healthcare benefits for diabetics. These benefits are intended to help diabetics afford to sustain their health, not for retailers to continue engaging in the privilege of doing business.

In this case, the diabetic consumers are coerced into giving up healthcare benefits *and* constitutional rights. They have

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[2]Naturally, 99% of California's pharmacies, if not 100%, could be expected to err on the side of caution in response to the Charlotte Paliani letter and charge the sales tax. (See Petitioners' AOB, at pp. 16-22.) A diabetic who would choose to shop for a pharmacy with "a more liberal view of the exemption" would have no luck.

neither the sales tax exemption nor the right to challenge the lack of exemption. As such, they have neither the healthcare affordability benefit nor the constitutional rights of due process or judicial review for a taking. They do not even have the minimum "any process of law" per this Court's statement in *National Ice.* (11 Cal.2d at p. 291.)

Because the prophesy of the dissent in *Diamond National* has occurred, diabetics suffer ongoing due process violations as they are forced to pay the "retailer's" tax obligations with no meaningful opportunity for hearing or review. Additionally, the confiscation of a financial obligation is a *per se* taking. (*Koontz, supra,* 133 S.Ct. at p. 2601.) The ability to purchase medical supplies is being conditioned upon the consumer paying "sales tax reimbursement" *and* relinquishing meaningful rights to make these claims.

During the many years of no opportunity to enforce the regulation exempting glucose test strips and lancets from sales tax, diabetics have had no choice but to surrender their constitutional rights in order to sustain their health. When they stand at the register at their local pharmacy, they lose their claims for refund instantly at point of sale.

III. Per *National Ice* and *Loeffler*, Courts of Appeal Should Not Defer All Consumer Sales Tax Issues to the Legislature under Article 13 Section 32 of the California Constitution.

Unconstitutionality is "made to appear" when "by the terms of the statute [the retailer] is authorized to compel the purchaser to assume the retailer's direct liability." (*National Ice, supra,* 11 Cal.2d at p. 292.) This has happened here. The Court of Appeal makes no mention of *National Ice,* however, in its discussion of due or other legal process. (*McClain, supra,* 9 Cal.App.5th at pp. 703-705.) Respondents avoid *National Ice.*

In *Loeffler v. Target Corp.* (2014) 58 Cal.4th 1081, this Court recently found that taxability should be determined first by the Board of Equalization, its relevant organizational counterpart now titled the Department of Tax and Fee Administration. Specifically, this Court has stated that a question of taxability is "committed in the first instance to the Board, subject to judicial review under the restrictions and pursuant to the procedures provided by the tax code." (*Id.* at p. 1100.) Further, what is known as the *"Javor* remedy" is appropriate because it "invokes, rather than avoids, tax code procedures." (*Id.* at p. 1101.) As the plaintiffs in *Loeffler* did not

pursue a *Javor* remedy, they did not pursue their claim through appropriate procedures. This Court then found it unnecessary to address constitutional questions because the case was resolvable under the tax code. Implicitly, *Loeffler* left the *Javor* remedy as available as it had been before. Hence, the constitutional and procedural rights of consumers vis-a-vis sales tax reimbursement did not come before this Court until *McClain.*

In *Loeffler*, this Court did not defer myopically to the Court of Appeal's emphasis on Article 13 section 32 of our constitution, but sought harmony in the tax code. (*Loeffler, supra,* 58 Cal.4th at pp. 1101-1103.) Unfortunately, like the *Loeffler* Court of Appeal, the *McClain* Court of Appeal defers simply to legislative power under Article 13 section 32 (9 Cal.App.5th at pp. 695-699), with little analysis of the tax code and an incorrect analysis of the resulting constitutional and procedural issues.

The *McClain* Court of Appeal skirts the constitutional and procedural issues by characterizing the money collected from customers as *not* taxes, and concluding therefore that no state action exists. To avoid the takings claim, however, it then characterizes the customers' money *as taxes* and concludes that

taxes are not takings. Specifically, the Court of Appeal reasons as follows: The retailer takes the money. The retailer is not the government, so there is no government action. The State then takes the money as taxes from the retailer, and the taxes can't be a taking. (*McClain, supra,* 9 Cal.App.5th at p. 704.) This is irreconcilable with this Court's view of the money in *National Ice.* In *National Ice*, the tax is "pass[ed] on" to the customer, with no indication that this changes its character. (*National Ice, supra,* 11 Cal.2d at pp. 290; 292.)

If *not* taxes, then the customers' money is being escheated to the State indefinitely, and thus presumably permanently, since the customer can only "tug at the sleeve" of the CDTFA. (*McClain, supra*, 9 Cal.App.5th at p. 705; Rev. & Tax. Code, § 6901.5.) No meaningful review being available, the customers' money is taken without due or any process. If *taxes*, then there *is* state action, and thus a due process issue as to its collection. Either way, the Court of Appeal was wrong to find no constitutional issue.

If there is no remedy for the injured diabetic consumers as they indefinitely await the Legislature post-*McClain*, irreparable injury exists which begs for a judicial solution. (*Helms Bakeries*

v. State Bd. of Equalization (1942) 53 Cal.App.2d 417, 421; *Ritter v. Patch* (1859) 12 Cal. 298.) As this Court stated in *Javor, supra,* 12 Cal.3d at p. 799: "It is still left to the courts to adopt appropriate remedies when excessive reimbursements have been collected by mistake and paid to the State." (See also *Ardon v. City of Los Angeles* (2011) 52 Cal.4th 241, 252; *Flying Dutchman Park, Inc. v. City and County of San Francisco* (2001) 93 Cal.App.4th 1129, 1141.)

In *Bates v. Franchise Tax Board* (2004) 124 Cal.App.4th 367, 379, the Second District Court of Appeal found that Article 13 Section 32 did not bar a claim under the Information Practices Act. Similarly here, Article 13 Section 32 should not preclude a court from enforcing a claim under a contractual obligation in the Civil Code. (Civ. Code, § 1656.1(d).) Unfortunately, disharmony in the tax code led the Court of Appeal to believe it was being asked to judicially manufacture a remedy the Legislature had not provided. Whether a remedy is truly missing, or the Court is simply being asked to harmonize conflicting statutes so that an existing remedy can be pursued, this Court may act. The Legislature has declared that "[f]or every wrong there is a remedy." (Civ. Code § 3523.) That

declaration serves as a guiding principle for interpreting the entire California Code. As a "maxim of *jurisprudence*," it also empowers the Court to provide a remedy where none exists. Therefore, the Constitution does not require that diabetic customers be turned away empty-handed, but rather that a remedy be recognized for the violation of their rights.

CONCLUSION

HJTA does not encourage undermining the tax code nor the policy of Article 13 section 32 of the California Constitution. (See Respondent CDTFA Answer Brief, at pp. 34-35.) Order and stability are necessary. The *McClain* Court of Appeal, however, has eliminated the *Javor* remedy which had protected the constitutional and procedural rights of consumers, the true sales tax payers, and had also simultaneously protected consumers from compelled permanent escheat of their money to the State, supposing they are *not* the true sales tax payers.

The statutory myth versus reality has created a paradox, but under either characterization of the customer as taxpayer or not, the consumer has no remedy remaining to dispute improper sales tax reimbursement paid in exchange for necessary medical

supplies. The consumer has no access to judicial review, whether to pursue improper sales tax collections or escheat of mere sales tax reimbursement. *McClain* must be reversed with instructions on these constitutional questions, and the *Javor* remedy re-instated in a practically useful manner.

WORD COUNT CERTIFICATION

I certify, pursuant to Rule 8.204(c), of the California Rules of Court, that the attached brief, including footnotes, but excluding the caption pages, tables, and this certification, as measured by the word count of the computer program used to prepare the brief, contains 3,480 words.

Dated: April 12, 2018

Respectfully submitted,

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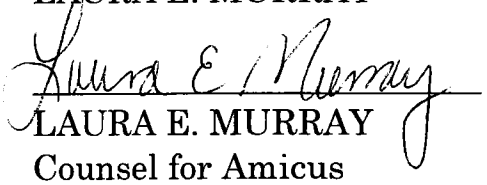

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SUPREME COURT OF CALIFORNIA

I am employed in the County of Sacramento, California. I am over the age of 18 years and not a party to the within action. My business address is: 921 11th Street, Suite 1201, Sacramento, California, 95814. On April 12, 2018, I served the attached document described as: **HOWARD JARVIS TAXPAYERS ASSOCIATION'S APPLICATION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE IN SUPPORT OF APPELLANTS** on the interested parties below, using the following means:

BY UNITED STATES MAIL I enclosed the documents in a sealed envelope or package addressed to the interested parties at the addresses listed below and on the attached page. I deposited the sealed envelopes with the United States Postal service, with the postage fully prepaid. I am employed in the county where mailing occurred. The envelope or package was placed in the mail at Sacramento, California.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on April 12, 2018, in Sacramento, California.

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