No. S173860

In the Supreme Court of the State of California

DICON FIBEROPTICS, INC.

Plaintiff and Appellant,

vs.

FRANCHISE TAX BOARD,

Defendant and Respondent.

REVIEW AFTER A DECISION BY THE COURT OF APPEAL
SECOND DISTRICT, DIVISION EIGHT, NOS. B202997
LOS ANGELES COUNTY SUPER. CT. NOS. BC367885

ANSWER BRIEF

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INTRODUCTION

The question presented is: Does a voucher certifying a hired worker's status as a "qualified employee" under the Enterprise Zone Act (the "Act"), issued by an expert agency expressly authorized to do so under the Act, constitute prima facie evidence of the hired worker's qualified status, which can only be rejected by the Franchise Tax Board ("FTB") upon an affirmative showing that the expert agency abused its discretion?

The answer is "Yes." As the Court of Appeal recognized, this result is compelled by the plain language of Revenue & Taxation Code Section 23622.7, which delegates authority to determine a hired worker's status as a "qualified employee" to expert agencies, not the FTB, as harmonized with the FTB's general statutory authority to audit and verify the accuracy of tax returns. The Act clearly reflects legislative intent to (**1**) vest discretionary decision making authority in the certifying agencies with expertise in assessing whether a hired worker meets the statutory "qualified employee" requirement for earning the Enterprise Zone employer tax credits for hiring disadvantaged workers; and (**2**) relieve Enterprise Zone employers from the burden of maintaining documentation necessary to supporting the hired worker's qualified status after it receives a voucher certifying the worker's qualified status from the certifying agency – all the employer is required to maintain is the agency-issued voucher.

To effectuate legislative intent under the Act, a certifying agency's expert assessment of a hired worker's status as a "qualified employee" cannot be subjected to rejection by the FTB in its role as auditor, absent an affirmative showing by the FTB that the certifying agency abused its discretion. This construction of the Act, in light of the FTB's general auditing authority, (**1**) honors the Legislature's clearly expressed intent to (i) delegate

discretionary decision-making authority to the expert certifying agencies and (ii) protect the Enterprise Zone employer from the burden of maintaining documentation necessary to prove to the FTB's satisfaction that the hired employee is qualified, (2) while reserving to the FTB the authority to reject agency certifications that the FTB can affirmatively shows to be in excess of the agency's discretionary authority.

The Court of Appeal's decision, having properly harmonized the Act's hiring credits requirements and purposes with the general auditing powers of the FTB, must therefore be affirmed.

STATEMENT OF THE CASE

On March 13, 2007, Dicon Fiberoptics, Inc. filed a complaint against the FTB seeking a tax refund based on tax credits earned under the Enterprise Zone Act, Gov. Code §7070 *et seq.* (the "Act"). *Appellants Appendix ("AA"), p. 1.* Dicon filed an amended complaint (the "Complaint") prior to the FTB's response, which is the operative pleading in this case.

The Complaint alleges that (1) Dicon earned tax credits under the Act worth $3.33 million for (2) hiring "qualified employees" to work within an Enterprise Zone, but (3) the FTB refused to honor $1.1 million worth of the claimed tax credits because (4) it determined that certain of the hired workers were not "qualified employees," even though (5) Dicon satisfied the Section 23622.7(c) requirements for establishing the "qualified" status of these workers by (i) seeking certification of the hired workers' qualified status from an agency authorized under the Act to make such a determination; (ii) obtaining from the agency a "voucher" certifying the "qualified status" of the hired employees, and (iii) submitting the vouchers to the FTB upon request. *AA, p. 18.* Dicon alleged that the FTB lacked statutory authority to deny tax credits on the ground that any of the hired employees were not "qualified

employees" because the Legislature delegated to the agencies identified in the Act sole authority to determine the qualified status of hired employees. *Id.*

The FTB demurred, arguing that the Complaint failed to state a viable tax refund claim because the FTB has the general authority to determine a workers' qualified status, without regard for the agency's determination. *AA, pp. 17-19.* The trial court sustained the demurrer and refused to grant Dicon leave to amend. *AA, p. 238.* The Court of Appeal reversed on two *alternative* grounds. *First*, the Court ruled that Dicon alleged facts sufficient to state a viable claim for a tax refund, even though the Court rejected the particular theory of recovery stated in the Complaint. *Slip Op., p.6.* *Alternatively*, the Court ruled that Dicon demonstrated that, if given an opportunity to file an amended complaint, it could state a viable claim for tax refund, thereby rendering the trial court's denial of leave to amend improper. *Id.*

The question presented by the FTB's Petition for Review does not challenge either ruling. Instead, it addresses an issue decided by the Court of Appeal in order to provide "guidance" to the parties and the trial court upon remand. *Slip Op., p. 7.* The Court of Appeal ruled that "vouchers are prima facie proof a worker is a 'qualified employee,' but FTB may audit such vouchers," although when it does so, it "bears the burden of rebutting the voucher's prima facie value, typically by proving the worker did not meet the criteria to be a 'qualified employee.'" *Id.* The Petition for Review challenges only that ruling. *Petition for Review, p. 1.*

I. THE COMPLAINT

A. The local agency issued hiring-credit vouchers worth more than $3 million

Dicon, a California corporation specializing in fiberoptics, researches, develops and manufactures products that filter, split, attenuate, switch,

combine, and monitor light. *AA, p. 15.* In 2003, Dicon sought certification for tax credits that it earned under the Act by hiring disadvantaged workers (described as "qualified employees" under the Act) to work within an Enterprise Zone during the year ending on March 31, 2001. Dicon sought certification from the local agency authorized to certify the qualified status of hired workers within the Enterprise Zone. *AA, p. 17.* The local agency confirmed that Dicon had established operations in the Enterprise Zone and it certified that numerous workers hired by Dicon were "qualified employees," thereby entitling Dicon to tax credits in the amount of $3,157,119. The agency thereupon issued "vouchers" evidencing its certification that the hired workers were "qualified employees" as defined under the Act. *AA, p. 17.*

On November 6, 2003, Dicon submitted to the FTB a timely claim for a tax refund supported by the tax credit vouchers issued by the certifying agency. *AA, p. 18.* By doing so, Dicon satisfied its obligations, under Section 23622.7(c), to demonstrate the "qualified" status of the hired employees by (1) obtaining certification (in the form of "vouchers") from an authorized agency and (2) retaining and presenting the vouchers to the FTB upon request.

On October 13, 2006, almost three years after Dicon submitted its November 6, 2003 tax refund request, the FTB rejected $1,104,992 worth of tax credits because the FTB disagreed with the local agency's determination that certain hired workers were "qualified employees." The FTB advised Dicon that it would not receive $1.1 million worth of credits unless Dicon submitted *additional* evidence (not requested by nor presented to the certifying agency) demonstrating the rejected employees' "qualified" status. Dicon, which had no documentation that was not already presented to the certifying agency, filed suit challenging the FTB's denial of the tax credits. *AA, p. 18, ¶15; Opening Brief on Appeal, pp. 5, 26-27; Reply Brief on Appeal, pp. 14-15.*

B. The FTB disagreed with the local agency's qualified-employee certification determinations

The FTB's Opening Brief erroneously implies that Dicon's vouchers were denied because there was no documentation whatsoever evidencing the qualified status of the rejected employees (other than the vouchers themselves). The implication is either that Dicon failed to provide supporting documentation to the local agency or that the local agency failed to provide Dicon's supporting documentation to the FTB. *Opening Brief, pp. 2, 4, 6.* But, contrary to the FTB's assertion, Dicon's Complaint (which must have been accepted as true for purposes of ruling on the demurrer) did **not** allege or admit that any of its vouchers requests were denied because Dicon failed to provide supporting documentation to the local agency or that the local agency failed to provide the supporting documentation to the FTB.

In fact, the FTB reviewed Dicon's supporting documentation, but nevertheless denied $1.1 million worth of vouchers due to a *difference of opinion* between the FTB and the local agency over the "qualified" status of certain hired employees, not due to an absence of documentation. Dicon intends to allege in an amended complaint that it submitted documentation *to the local agency* supporting *all* of its voucher requests. Dicon will allege with particularity that (1) the local agency maintained the supporting documentation (even though the Department of Housing and Community Development did not promulgate its record-keeping regulations until after Dicon filed for tax credits) and (2) the documentation was available to and reviewed by the FTB. Thus, contrary to the FTB's implication, Dicon will allege that (**1**) all of its voucher requests to the local agency were evidenced by documentation supporting the hired workers' "qualified" status and (**2**)

Dicon's documentary evidence was (i) maintained by the local agency, (ii) available to the FTB, and (iii) actually reviewed by the FTB.

II. THE DEMURRER AND TRIAL COURT RULING

The FTB demurred to the Complaint, attacking Dicon's theory that the FTB lacks statutory authority to review and reject the certifying agency's employee-qualification determinations. *AA, p., 32.* Although the Act expressly authorizes the agencies listed in Revenue & Taxation Code Section 23622.7(c)[1] to determine whether hired workers are "qualified employees" under the Act, the FTB argued that its general power to audit and review tax returns (Sections 19032 and 19501) implicitly confers upon it the authority to determine *independently* whether hired workers certified by the local agencies actually meet the qualified-employee standard. *AA, pp. 38-39.* Dicon opposed the demurrer, arguing that the Legislature expressly delegated exclusive authority to the certifying agencies with expertise on matters of local business conditions and employment opportunities. *AA, pp. 58-59, 61-63.*

The trial court sustained the demurrer, ruling that the FTB's general authority to ascertain the correctness of tax returns empowers it to reject the certifying agency's exercise of judgment in making a "qualified employee" determination. *AA, p.238.* Although Dicon expressly requested leave to amend *(AA, p. 72),* the trial court sustained the demurrer without leave to amend. *AA, p. 238.*

III. THE COURT OF APPEAL'S DECISION

Dicon argued on appeal that (1) the Complaint states a viable claim for tax refund because the FTB lacks the statutory authority to second-guess a

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[1] Statutory references are to the Revenue & Taxation Code, unless otherwise specified.

local agency's determination that hired individuals for whom vouchers were issued are "qualified employees" under Section 23622.7(b)(4)(A) or, *alternatively*, (2) Dicon should have been granted leave to amend because, even if the FTB has statutory authority to review such determinations, it erroneously determined that the rejected vouchers were improperly issued. *Opening Brief on Appeal, pp. 1-3, 10-19, 31-34.*

The Court of Appeal reversed, holding that the Complaint alleged facts sufficient to state a cause of action against the FTB for a tax refund. *Slip Op., p.6.* While the Court of Appeal rejected Dicon's theory that the FTB lacks any authority to reject vouchers issued by statutorily-authorized local agencies, it nevertheless concluded that the Complaint adequately alleges that vouchers were improperly denied on the merits. *Id.* Alternatively, the Court held that the trial court should have granted Dicon's request for leave to amend. *Id.* The Court ruled that Dicon demonstrated on appeal that it could state a viable tax refund claim by alleging that the FTB incorrectly denied vouchers based on (1) the FTB's improper application of an unlawfully demanding standard of proof for demonstrating a hired worker's qualified status, and (2) the FTB's improper refusal to accept vouchers for workers whose eligibility to participate in certain economic assistance and jobs programs satisfied the "qualified employee" requirement as a matter of law, thereby warranting the issuance of vouchers. *Slip Op., p.7.*

The Court of Appeal also addressed "the unanswered legal question looming over these proceedings: Does FTB's authority to examine and audit tax returns permit FTB to reject a voucher issued by a local employment or social service agency" and, if so, what weight (if any) must be given to the local agency's determination? *Slip Op., p.7.* The Court of Appeal answered as follows: "We hold that vouchers are prima facie proof a worker is a 'qualified

employee,' but FTB may audit such vouchers. In such an audit, FTB bears the burden of rebutting the voucher's prima facie value, typically by proving that the worker did not meet the criteria to be a 'qualified employee.' In trying to meet that burden, FTB may not rely on the employer's failure to produce during the audit documents establishing a worker's eligibility to the extent regulations governing the tax credit charge the enterprise zone, not the employer, with the obligation to maintain documents of workers' eligibility." *Id. at 7-8.*

In so concluding, the Court of Appeal harmonized the Legislature's clearly-expressed intent to delegate decision-making authority to the certifying agencies with the FTB's general authority to assure the accuracy of tax returns.

LEGAL ARGUMENT

I. THE FTB CANNOT SECOND-GUESS "QUALIFIED EMPLOYEE" DECISIONS MADE BY THE EDD OR LOCAL AGENCIES

A. The Act Delegates Authority To Determine A Worker's *Qualified* Status To The EDD And Local Agencies

Section 23622.7(c) expressly delegates responsibility for determining whether hired workers meet the "qualified employee" requirement to the Employment Development Department (EDD) and local agencies administering the Enterprise Zone or administering a number of identified job/training programs (collectively referred to as "local agencies") and their agents. By delegating decision-making responsibility to the EDD and local agencies with expertise in economic and employment-related issues, the Legislature increased the probability that tax credits would be earned by Enterprise Zone employers hiring truly disadvantaged workers.

The Act's express delegation language precludes a construction that would allow the FTB, under the guise of performing its general auditing

functions, to second-guess the EDD's or a local agency's expert judgment that the qualified-employee standard has been satisfied. The FTB nevertheless argues that its general statutory authority to audit tax returns implicitly allows it to determine *independently* a hired worker's qualified status, without paying any deference whatsoever the EDD's or to a local agency's expertise.

The current dispute between Dicon and the FTB is not whether the FTB has authority, as auditor, to reject vouchers that were issues in excess of the certifying agencies' discretionary authority. Dicon accepts that the FTB's general authority empowers it to reject vouchers if (but only if) the FTB shows, by affirmative evidence, that the certifying agency's determination was an abuse of its discretionary authority. The parties disagree as to whether the FTB has statutory authority to substitute its own judgment for that of the certifying agencies. Dicon contends that the Act's clear statutory delegation of discretionary authority to the expert agencies precludes the FTB from nullifying their exercise of discretionary authority. The FTB's construction, which arrogates to itself a power to reject certifying determination based on a mere difference of opinion, must be rejected because it would defeat the clearly expressed legislative intent to vest the expert agencies with discretion to determine whether a hired worker is a "qualified employee."[2]

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[2] While this case involves certification determinations made by a local agency, the statutory language applies with equal force to determinations made by the EDD. Thus, the FTB's contention that, in performing its auditing function, it may reject a certification determination made by a local agency, necessarily implies that it may likewise disregard certification determinations made by the EDD because there is no basis in the statutory language for distinguishing between the EDD and the local agencies.

1. The Act offers tax credits to stimulate the hiring of disadvantaged workers in Enterprise Zones

The Act authorizes local governments to designate and manage Enterprise Zones within their jurisdictions upon approval of the "Enterprise Zone" designation by the California Department of Housing and Community Development ("DHCD"). *Gov. Code §7073.* The FTB disparages Enterprise Zones and their administrators by characterizing them as functioning "more like a trade group or marketing organization whose primary function is to attract and accommodate enterprise zone employers." *Opening Brief, p. 4.* But the promotion of business and the employment of disadvantaged workers in Enterprise Zones are legitimate legislative goals expressly promoted by the Act. Indeed, the purpose of the Act is to encourage business development in depressed areas through economic and regulatory incentives, thereby encouraging private investment. *Gov. Code §7071(a).*

The Legislature's strong desire to stimulate economic growth in Enterprise Zones is reflected by the statutory directive that the DHCD assist local governments in "marketing" their Enterprise Zone programs, that the DHCD "help businesses to participate in [such] program[s]," coordinate the activities of other state agencies to facilitate Enterprise Zone goals, and make the provision of such services "a high priority of the Department." *Gov. Code §7076.* The promotion of Enterprise Zone programs by local governments is therefore a guiding principle for the successful implementation of the Act.

Among the Act's tools for Enterprise Zone revitalization is the "hiring credit." Section 23522.7(a) provides that qualified Enterprise Zone employers may earn tax credits for hiring disadvantaged workers. The hiring credit provision allows a qualified employer who hires a "qualified employee" to earn credits against tax liabilities attributable to the employer's

Enterprise Zone activities. *Id.* The Act thereby provides an economic incentive for businesses in Enterprise Zones to hire disadvantaged workers.

2. The Act expressly authorizes the EDD and local agencies to determine a worker's *qualified* status

When the Act was first promulgated, the question of whether a hired worker faced sufficient employment disadvantages to earn the employer a tax credit was answered by reference to a simple, non-discretionary standard. A tax credit was earned, among other ways, by hiring a worker *enrolled* in an economic assistance or job program listed in the Act.[3] But in 1994, the Legislature expanded the scope of the "qualified employee" category, widening coverage from those who *participated* in a listed program to those *eligible to participate* in a programs. *AA, 84 (Assem. Com. on Revenue and Taxation, Analysis of Sen. Bill No. 1770 (1993-1994 Reg. Sess.) as amended June 2, 1994.*

The question of whether a worker is *eligible* to participate in one of the economic assistance or job programs covered by the Act raises a different *kind* of question than whether a worker is *actually enrolled* in such a program. Under the pre-1994 statutory framework, where the question was simply whether the worker was an actual participant in a covered program, the employer simply applied to the FTB for a tax credit based on documentation proving the worker's actual participation in a qualifying program. The FTB, as auditor, could easily verify the hired worker's participation through the documentation.

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[3] The economic assistance and job programs covered by the Act include the Job Training Partnership Act (JTPA) and its successor program, the Workforce Investment Act; the Greater Avenues for Independence Act of 1985 (GAIN); unemployment insurance benefits available to dislocated workers; a "state rehabilitation program" for disabled workers; and benefits under Supplemental Security Insurance, Aid to Families with Dependant Children, food stamps, or state or local general assistance. *Rev. & Tax. Code § 23622.7(b)(4)(A)(iv)(I).*

No expertise in local economic or employment conditions was required to verify the employee's participation in a covered program. Thus, there was no statutory requirement before 1994 that the qualified status of hired workers be certified as a prerequisite to seeking tax credits.

But the 1994 amendment changed the nature of the "employee qualification" requirement by expanding the scope of qualified employees to those eligible to participate in one of the listed programs. Whether a particular worker is *eligible* to participate in a covered program is a question that will often require the exercise of judgment. And the judgment that must be exercised in assessing a worker's eligibility is aided by having expertise in local business and employment conditions, which are subjects within the expertise of the EDD and the local agencies, but not the FTB. *See* Cal. Franchise Tax Board, summary analysis of Sen. Bill No. 2023 (1995-1996 Reg. Sess.) Sept. 6, 1996, as amended Aug. 31, 1996, p. 6.

The broader scope of the amended "qualified employee" requirement – and the discretionary nature of the new definition – caused the Legislature to protect against fraud or mistake by requiring those seeking tax credits to obtain certification of a hired worker's "qualified employee" status from a neutral third party with expertise in applying the conditions that make one eligible to participate in one of the covered programs. The Act delegates responsibility for certifying that a hired worker meets the statutory standard to the EDD and local agencies with such expertise:

> "The taxpayer shall . . . (1) Obtain from the Employment Development Department, as permitted by federal law, the *local* county or city Job Training Partnership Act administrative agency, the *local* county GAIN office or social services agency, or the *local* government administering the enterprise zone, a

certification that provides that a qualified employee meets the eligibility requirements . . . " *§23622.7(c) (emphasis added).*

Thus, employers seeking tax credits for hiring qualified employees must obtain a "voucher" from a statutorily-authorized agency (whether the EDD or a local agency) certifying that the hired workers are "qualified employees." This express delegation of decision-making authority to the EDD and the local agencies is the Act's *exclusive* delegation of decision-making authority on the limited question of whether a hired individual is a "qualified employee."

3. The statutorily-identified agencies have expertise in assessing a disadvantaged worker's *qualified* status

Why did the Legislature single-out the EDD and local agencies to certify the disadvantaged status of hired workers? Because these agencies have the expertise needed to make accurate determinations. The assessment of eligibility for participation in one of the Act's listed programs often requires the exercise of judgment and the EDD and local agencies have expertise in assessing the factors that make someone eligible to participate in the covered economic assistance and job programs.

The need for expertise flows from the statute's broad definition of "qualified employee" as a person who, immediately prior to employment, is any of the following: **(1)** Eligible for services under the federal Jobs Training Act (or its successor, the federal Workforce Investment Act) or who is receiving or is eligible to receive subsidized employment, training or services funded by the federal Jobs Training Act (or its successor); **(2)** Eligible to be a voluntary or mandatory registrant under the State's Greater Avenues for Independence Act of 1985, codified under Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code ("GAIN"); **(3)** An "economically disadvantaged individual"

14 years of age or older; **(4)** A "dislocated worker" who meets *any* of the following requirements: ***(a)*** Has been terminated, laid off or received notice of termination or layoff, is eligible for or has exhausted unemployment insurance benefits, and is "unlikely to return to his or her previous industry or occupation;" ***(b)*** Has been terminated, laid off or received notice of termination or layoff as a result of any permanent closure or any substantial layoff at a plant, facility, or enterprise; ***(c)*** Is long-term unemployed and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides, including an individual 55 years of age or older who may have substantial barriers to employment by reason of age; ***(d)*** Was self-employed and is unemployed as a result of general economic conditions in the community in which he or she resides or because of natural disasters; or ***(d)*** Is a seasonal or migrant worker who experiences chronic seasonal unemployment and underemployment in the agricultural industry, aggravated by continual advancements in technology and mechanization. *Rev. & Tax. Code §23622.7(b)(4)(A)(iv).*

Whether an individual is eligible to participate in the Jobs Training Partnership Act ("JTPA"), or its successor, the federal Workforce Investment Act, or the GAIN program requires an *individualized assessment* of (1) the particular employee's situation and (2) business conditions and job opportunities in the local area. The necessity for expertise on employment-related issues and local business conditions is made explicit by the EDD-promulgated Technical Assistance Guidelines for local agencies in determining eligibility for benefits under the federal Workforce Investment Act ("WIA"). *AA, pp. 98-101, 102-163.*

The EDD Technical Assistance Guidelines make clear that local discretion is often a significant aspect of a WIA eligibility determination.

Section I of the EDD Technical Assistance Guidelines, titled "Locality Flexibility," emphasizes that (1) the WIA "provides local areas increased flexibility to implement systems that best suit the needs of local communities" and (2) the "State of California supports the idea that local workforce investment areas are best positioned to exercise this flexibility, which aids in ensuring a strong role for local boards in California's workforce investment system." *AA, p. 107 (WIA Eligibility Technical Assistance Guide).* The flexible WIA standards governing local agencies in determining an employee's eligibility make clear that such local, non-tax issues are ill-suited for FTB resolution. The EDD's Guidelines confirm that local authorities rely on their locality-based expertise in assessing eligibility for program participation:

> "**Eligibility Documentation and Verification**
>
> The [WIA] and the regulations do not address the issues of eligibility documentation and verification. The [Department of Labor "DOL"] has not yet provided eligibility documentation and verification guidance; however, DOL allows *considerable state and local flexibility* in this area. Therefore, *local areas are at liberty to establish their own documentation and verification policy and procedures.*
>
> The documentation and verification process should be *customer friendly* and not add to the frustrations already experienced by individuals who are out of work. It is the purpose of WIA programs to assist people who are having difficulty finding employment. It is not the intention of this program to discourage participation by imposing difficult documentation and verification requirements. *Local areas have the flexibility and local discretion to design documentation and verification systems that are less burdensome than the predecessor programs.* Section X of this technical assistance guide includes a form for local areas to use in developing their own lists of acceptable documentation. Sample tables of acceptable documentation are also included *(Attachment 2)* for local areas to adopt *if they choose not to develop their own.*" *AA, p. 109* (emphasis added).

The necessity for exercising judgment and expertise in such local business and employment-opportunity matters is *further* necessitated by some of the Act's other eligibility options, which likewise require the exercise of judgment on matters outside the FTB's area of expertise:

- Whether the employee was, before being hired, "an economically disadvantaged individual." *§23622.7(b)(4)(iv)(III)*;
- Whether the employee was "a dislocated worker" who:
  - was "unlikely to return to his or her previous industry or occupation"; *§23622.7(b)(4)(iv)(III)(aa);*
  - was "long-term unemployed" and "has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides;" *§23622.7(b)(4)(iv)(III)(cc);*
  - was self-employed and is unemployed "as a result of general economic conditions in the community in which he or she resides;" *§23622.7(b)(4)(iv)(III)(dd); or*
  - who "is a seasonal or migrant worker who experiences chronic seasonal unemployment in the agriculture industry, aggravated by continual advancements in technology and mechanization." *23622.7(b)(4)(iv)(III)(gg).*

The Legislature's purpose in adopting the highly discretionary eligible-for-program-benefits standard was to make tax credits available for the hiring of a much wider pool of disadvantaged individuals facing employment obstacles. *AA, pp. 84-85(Assem. Com. on Revenue and Taxation, Analysis of Sen. Bill No. 1770).* Proper identification of those qualified for program benefits necessitates a consideration of local business conditions and employment opportunities, subject matters that fall outside the FTB's tax-related area of expertise. The Legislature's purpose would be sacrificed if, as the FTB argues, it is deemed to have the implied power to substitute its own *non-expert* judgment for that of the EDD or local certifying agencies with the expertise

necessary to determine an employee's qualifications in light of local business conditions and employment opportunities.

B. The Legislature's Delegation Of Discretionary Authority To Certifying Agencies Prohibits The FTB From Nullifying Their Discretionary Determinations

The FTB contends that its general auditing authority allows it to determine *independently* whether hired workers are qualified employees under the Act, without according *any deference* to the expert agency's determination. A consequence of the FTB's interpretation is that the exclusive statutory grant of authority to the EDD and local agencies to determine the qualified status of hired workers would be subject to FTB nullification whenever the FTB disagrees with an expert agency determination. That unilateral power would defeat the Legislature's specifically-expressed intention to vest the expert agencies with discretionary authority to certify a worker's "qualified" status.

1. The statute reflects legislative intent that the certifying agencies determine employee qualification

The cardinal rule of statutory construction is to ascertain and effectuate legislative intent within the parameters of statutory language. Code of Civil Proc. §1859; *People v. Coronado*, 12 Cal.4th 145, 151 (1995). All other rules of statutory construction are subject to this controlling principle because the object and purpose of statutory interpretation is to determine the Legislature's intent. *Los Angeles Co. v. Frisbee*, 19 Cal.2d 634, 639 (1942). Here, the plain language of Section 23622.7(c) delegates to the EDD and local agencies the authority to certify a hired worker's qualified status. This clearly-expressed delegation of decision-making authority reveals the Legislature's obvious and presumptively controlling intent to entrust the certifying agencies with responsibility for determining whether hired workers meet the qualified-employee standard. Cf. *City of Santa Monica v. Gonzalez*, 43 Cal.4th 905, 919

(2008) ("the statutory language is usually the most reliable indicator of legislative intent"). This Court must therefore "give the statute a reasonable construction conforming to [that] legislative intent." *Id.*

The exclusive nature of the statutory delegation belies any implication that the Legislature intended that the FTB, wielding its general auditing powers, could nullify an agency certification simply because it disagrees with the agency's judgment. The explicit statutory reference to the listed certifying agencies precludes any assumption that another agency, not mentioned in the statute, has the implicit or merely general authority to reject their certification determinations. Had the Legislature intended to authorize the FTB to independently review and reject discretionary determinations by certifying agencies without showing an abuse of discretion, it would have said so expressly in the statute. See *Dyna-Med, Inc. v. Fair Employment & Housing Comm.*, 43 Cal.3d 1379, 1391 & n. 13 (1987) (applying the rule of *expressio unius est exclusion alterius*, "the expression of some things in a statute necessarily means the exclusion of other things not expressed").

The FTB has made the converse argument, that if the Legislature had intended to vest the certifying agencies with *exclusive* decision-making authority, not subject to nullification by the FTB, it would have so provided. The FTB's argument, however, overlooks the fact that the Legislature expressly delegated discretionary decisional authority to the certifying agencies by listing them in Section 23622.7(c), without qualifying that authority or otherwise implying that their discretionary determinations would be subject to nullification by the FTB without any deference. It would make no sense for the Legislature to vest discretionary authority in the statutorily-identified agencies with expertise in the subject matters relevant to the qualified-employee inquiry, only to allow their decisions to be second-guessed by the

FTB, without requiring any deference whatsoever, even though the FTB lacks the substantive expertise of the certifying agencies.

Section 23622.7(c) also reveals the Legislature's intent to delegate decisional authority to the EDD and local agencies by expressly limiting the taxpayer-employer's record-keeping obligations in a manner inconsistent with the risk of *de novo* FTB reconsiderations and rejection of the agency's certification determination. Section 23622.7 limits the taxpayer's record-keeping obligation to (1) obtaining a voucher from the EDD or an authorized agency and (2) retaining the voucher for presentation to the FTB upon its request. This statutory certification system implies that (1) the authorized agency, whether the EDD or a local agency, determines whether a hired worker is qualified; (2) it issues a voucher certifying the worker's qualified status; and (3) the FTB satisfies its auditing function by obtaining the voucher from the employer seeking tax credits – not by making its own, independent determination of whether the worker is qualified.

2. The agencies' specific discretionary authority trumps the FTB's merely general auditing authority

The FTB argues that its *general* powers to administer the Revenue and Taxation Code and determine the correct amount of corporate taxes trump the Legislature's *specific* delegation of discretionary certification authority to the EDD and local agencies. Thus, according to the FTB, the Legislature's silence as to whether the FTB has authority to independently assess and reject discretionary agency determinations gives rise to a presumption that the FTB has such authority.

But the rules of statutory construction demonstrate that just the opposite is true: "[I]t is a rule of statutory construction that a specific statute shall take precedence over a more general one touching on the same subject."

Santa Clara Valley Transp. Authority v. Rea, 140 Cal.App.4th 1303, 1318-1319 (2006); *De Anza Santa Cruz Mobile Estates Homeowners Assoc. v. De Anza Santa Cruz Mobile Estates*, 94 Cal.App.4th 890, 911-912 (2001) ("it is a generally accepted rule of statutory construction that a general statute must bow to a more specific statute addressing the same subject"). Thus, "a special statute dealing with a particular subject constitutes an exception so as to control and take precedence over a conflicting general statute on the same subject." *Turlock Irrigation Dist. v. Hetrick*, 71 Cal.App.4th 948, 953 (1999), quoting *Conservatorship of Ivey*, 186 Cal. App. 3d 1559, 1565 (1986); *People v. Tanner*, 24 Cal.3d 514, 521 (1979). The special delegation of authority supplants the general "notwithstanding that the general provision, standing alone, would be broad enough to include the subject to which the more particular one relates." *Id.* Construing the FTB's powers to trump the specific authority granted under §23622.7(c) would undermine legislative intent to delegate responsibility and flexibility to the agencies with expertise.

This delegation does not undermine the FTB's auditing function. It streamlines and facilitates the FTB's role in auditing the "qualified employee" requirement by (1) requiring that the certifying agency document its determination by issuing a voucher, and (2) providing the voucher to the taxpayer, who must (3) provide it to the FTB upon request. *Rev. & Tax. Code §23622.7(c)(2).* This statutory requirement implies that the FTB's role, in auditing the "qualified employee" requirement, is to verify that an authorized agency issued the requisite voucher – not to independently assess the validity of that certification or otherwise require the taxpayer to "prove" a hired worker's "qualified" status to the FTB's satisfaction. Had the Legislature intended to subject the taxpayer to *de novo* FTB review of the agency certification, then the statute would not simply instruct taxpayers to maintain

the agency vouchers. The statute would have warned taxpayers to maintain all documents necessary to support a finding of employee qualification. The statute, however, simply requires taxpayers to retain the agency-issued voucher. Unless the Legislature intended to create a trap for the unwary, which it obviously did not, the limited document-retention requirement implies that the agency's determination is not subject to *de novo* FTB review.

C. The Act Limits The FTB's General Auditing Authority Over Hiring Credits

The FTB has argued that Dicon's construction of Section 23622.7(c) as vesting decision-making authority in the EDD and local agencies would usurp the FTB's statutory duty to audit tax returns. The FTB's argument is based on the presumption that its authority to audit tax returns necessarily implies the power to review the correctness of any decision serving as a pre-requisite to earning a tax-related benefit on a *de novo* basis, even an administrative determination that involves the exercise of judgment by an agency with expertise not shared by the FTB. There is no basis in law or logic for that presumption.

Where the statute provides that another agency is responsible for certifying an element necessary to obtain a tax benefit, such as the "qualified employee" requirement, the taxpayer demonstrates it has satisfied that element by documenting that it has received the required determination. The delegation of discretionary decision-making authority to an expert agency does not usurp the FTB's auditing authority, it merely alters the scope of the audit. Instead of determining independently whether a hired worker is a qualified employee, the FTB's auditing function is to verify that an authorized agency has issued a voucher and, in doing so, acted within its discretionary authority. Thus, the FTB remains fully empowered to audit the tax returns of those

seeking hiring credits and determine the veracity of those returns, but (1) it cannot substitute its own judgment for that of the agency authorized to make a discretionary determination and (2) it cannot base its assessment on the taxpayer-applicant's failure to produce supporting documents to the FTB because the Act expressly limits to taxpayer-employer's duty to maintain and produce supporting documentation.

The Act's use of the term "certification" makes clear that Dicon's construction is fully consistent with (not a usurpation of) the FTB's role as auditor. Section 23622.7(c)(1) states that a taxpayer claiming a credit for hiring a qualified employee must obtain *certification* from a statutorily-authorized agency, thereby verifying that the hired employee is "qualified." The word "certification," which is commonly defined as the act of certifying or the state of being certified, is derived from the words "certificate" and "certify." *Webster's II New College Dictionary*, p. 183 (2001). A "certificate" is "a document testifying to accuracy or truth." *Id.* To "certify" is "to confirm formally as true, accurate or genuine, esp. in writing." *Id.* Agency certification of an employee's "qualified" status, which is documented through a written voucher, therefore confirms "formally as true, accurate or genuine" the employee's qualification under the Act. The FTB, by obtaining the voucher from the taxpayer, thereby satisfies its traditional auditing function by confirming through the documentary record that the hired worker's status has been certified in the manner required by law.

Consider also that hiring credits are earned by hiring workers who receive or are eligible to receive food stamps. *Rev. & Tax. Code § 23622.7(b)(4)(A)(VII).* Applying the FTB's logic to vouchers earned by hiring recipients of food stamps, the FTB's auditing power would presumably authorize it to determine whether the hired workers were actually eligible to

receive food stamps, although it lacks the expertise to make that determination. The FTB could not, according to the logic of its argument, be required to accept the legitimacy of another agency's (expert) determination that the food stamp recipients were actually eligible to receive the food stamps they received. (Certainly, the Legislature did not intend to award tax credits for hiring workers who fraudulently participated in the food stamps program.) The same logic would apply to any worker whose qualified status is based on the receipt of a benefit or service or participation in a covered program. Just as the FTB argues that it is not required to accept the expert determination behind a certifying agency's voucher, so too does logical consistently require it to argue that it is not required to accept the legitimacy of another agency's (expert) determination the a hired worker was entitled to receive qualifying benefits or participate in covered programs.

The impropriety of the FTB's position, whereby it arrogates to itself the unrestricted power to determine whether a hired individual is a "qualified employee," without any deference to the Section 23622.7(c) agency's expert determination, is further illustrated by considering this hypothetical: Suppose that the Legislature enacted a statute providing a tax exemption for individuals with a specified form of chromosomal damage, the identification of which requires the exercise of judgment based on the presence or absence of various indicia of the condition – none of which are determinative, but are considered relevant by those with expertise in making a diagnosis. The statute conferring this exemption further provides that individuals seeking to claim this tax benefit must submit to physical examinations by one of several listed expert agencies with scientific and medical expertise in diagnosing the (difficult to verify) condition. Finally, the statute provides that a taxpayer seeking to claim the

exemption must (1) retain a copy of the written "voucher" certifying the agency's determination and (2) present it to the FTB upon request.

The FTB would satisfy its auditing function under this hypothetical by obtaining a copy of the voucher. If, however, the FTB has reason to suspect fraud or mistake, it may conduct its own investigation, but in doing so it cannot require that the taxpayer submit to another physical examination just because the FTB's own expert might draw a different conclusion. But, applying the FTB's interpretation to the hypothetical, it would claim for itself the general authority to determine independently whether the taxpayer has the requisite chromosomal condition. That authority would empower the FTB to establish, to its own satisfaction, that the taxpayer suffers from the requisite condition, without deference to the statutory agency's medical/scientific determination. Indeed, under the FTB's interpretation, its auditors, lacking medical or scientific expertise, could make their own independent (non-expert) judgments about whether there are sufficient indicia of the requisite condition. The FTB's general "auditing" function, as posited by the FTB, would thereby usurp the judgment of the legislatively-selected expert agency.

There is no significant difference between the hypothetical and the situation presented in this case. The hypothetical simply demonstrates in more graphic terms the manner in which the FTB's interpretation would effectively nullify the legislative delegation of discretionary authority to the expert agencies. If the FTB is deemed to have the general power to exercise its own independent judgment, though lacking the expertise of the legislatively-identified agencies, then the Legislature's specific delegation to the expert agencies would be usurped by the FTB's merely general auditing function.

D. The Legislature Balanced The Act's Competing Goals By Delegating Authority To The Certifying Agencies

The primary purpose of the Act's hiring credit is to encourage Enterprise Zone businesses to hired disadvantaged workers. And by expanding the scope of the "qualified employee" category, the Legislature hoped to encourage the hiring of a broader range of disadvantaged workers. The Legislature was, however, concerned that by expanding the scope of "qualified employees" to include those eligible for covered benefits, the risk of fraud and mistake also increased. The FTB, focusing on the risk of fraud to the exclusion, argues that the Legislature must have intended that the FTB have the power to determine a hired worker's qualified status independent of the expert agency's determination because a second layer of de novo review would protect against the risk of fraud. *Opening Brief, pp. 25-26.* What the FTB fails to acknowledge is that the Legislature chose to reduce the risk of fraud or mistake by delegating certification authority to the experts – the EDD and local agencies – not the FTB.

1. "Qualified employee" was expanded to promote the hiring of a broader class of disadvantaged workers

The plain language of Section 23622.7(c) reveals that the Legislature balanced the primary goal of encouraging the hiring of disadvantaged workers with the subordinate concern about the risk of fraud/mistake by delegating responsibility for confirming the hired worker's "qualified" status to the agencies with sensitivity to and expertise in assessing the conditions that render a worker disadvantaged in the local employment market. This certification procedure was the Legislature's plainly chosen method for balancing incentive promotion and fraud prevention.

The FTB, however, takes a myopic glance at the legislative history, implying that the Legislature was obsessed by the fear of fraud, but somehow too paralyzed by that fear to take direct, corrective legislative action. *Opening Brief, pp. 25-26.* The FTB cites legislative history indicating that legislators opposed to a prior, *rejected* version of the 1994 Amendment were concerned about the risk of fraud created by expanding the definition of "qualified employee" to workers merely eligible for participation in covered programs. While this legislative history accurately reflects legislative concern with a *prior* version of the bill, the FTB ignores the legislative response to that concern. The Legislature chose to protect against the risk of fraud or mistake by requiring certification of hired workers' qualified status by the EDD or local agencies with expertise. This was the chosen statutory mechanism for protecting against the risk of fraud or mistake, without over-compensating by imposing anti-fraud/mistake protections that would increase the burden of seeking hiring credits, thereby impairing the Act's hiring incentive.

The primacy of the Legislature's goal of promoting the hiring of a broad class of disadvantaged workers, and its concern that the prior incentive structure was inadequate to that task, is obvious from the legislative history. In 1994, the Legislature determined that that the economic incentives for hiring disadvantaged workers were far too narrow to have the intended impact on hiring within Enterprise Zones. Consequently, the Legislature decided to broaden the class of "qualified employees" to cover those eligible for program benefits. *AA, p. 84 (Assembly Comm. on Rev. & Taxation, SB 1770, Aug. 15, 1994)* (noting that the 1994 amendment "deletes the requirement that a person must be receiving specific job training services in order to qualify for the current EZ hiring credit and specifies only that the person must be eligible for

services").[4] The 1994 amendment was designed "to broaden the pool of individuals whom an Enterprise Zone employer can hire and still qualify for the EZ hiring tax credit." *Id.* By expanding the scope of "qualified employee" to "cover anyone who meets the eligibility requirements for the specified programs, regardless of whether they have ever attempted to enroll for services," the Legislature abandoned the former, objectively-discernable standard. *AA, p. 84-85.* Proponents of the revision believed that by loosening the standards for qualification, the amendment "will result in a greater number of low-income employees being hired." *AA, p. 84-85.*

2. The EDD/local agency certification requirement was intended to prevent fraud or mistake

The Legislature recognized that by adopting a "qualified employee" standard that depended upon a discretionary assessment of a hired worker's status, it enhanced the risk that some employers might (inadvertently or intentionally) seek hiring credits for employees who were not qualified. *AA, p. 85 (Assembly Comm. on Rev. & Taxation, SB 1770, Aug. 15, 1994).* That type of risk is an inherent problem with the selection of a "soft," discretionary standard for determining employee qualification. Unlike the prior non-discretionary standard, eligibility for participation in the job-related benefit programs cannot always be verified by a single document evidencing the employee's actual participation in a specified program. Instead, confirmation of an employee's eligibility often necessitates an individualized analysis, taking into account individual and locality-based variables, such as those identified in

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[4] This broad definition was retained when the Legislature combined the Enterprise Zone Act of 1984 and the Employment and Economic Incentive Act of 1985 into the 1996 Act. *Rev. & Tax. Code §23622.7(b)(4)(A)(iv)(I)-(VI).*

the EDD's Technical Assistance Guidelines for determining eligibility for participation in the Workforce Investment Act (AA, p. 98-163).

The Legislature chose to protect against the risk of mistake or fraud by empowering the EDD and local agencies with expertise in assessing program eligibility requirements to certify that those qualifying requirements have been satisfied. *Rev. & Tax Code § 23622.7(c).* The statutory certification requirement was the Legislature's direct response to the enhanced risk of fraud inherent in the new qualified-employee standard. It protects against the risk of fraud or mistake without exposing hiring employers to prove-up procedures that might dilute the statutory incentive structure.

3. The FTB is ill suited to operate an incentive program designed to reduce tax liabilities

The FTB has effectively characterized the Section 23622.7(c) certification system as akin to a rooster guarding the hen house. It implies that the Legislature could not reasonably have intended to delegate decision-making authority to local agencies because they are too closely tied to promoting Enterprise Zones and, therefore, would exercise their discretion to maximize use of the hiring incentive. But it is far more likely that the Legislature knew precisely what it was doing when it put the certifying agencies in charge of making employee-qualification decisions. The Legislature's primary goal was to encourage the hiring of disadvantaged workers and that purpose is aided by granting decision-making authority to agencies with expertise and a desire to promote the incentive program. By contrast, the Legislature surely understood that the FTB, with a natural institutional bias favoring the accumulation of tax revenues, would lean sharply in the direction of maximizing tax revenues. That is why Section

23622.7(c) identifies the EDD and local agencies as the certifying agencies, not the FTB.

The FTB's actions in seeking to usurp the certifying agencies' statutory role evidences the institutional bias that likely influenced the legislative preference for the certifying agencies. The FTB has expressed open disdain for Enterprise Zone hiring credits in this case: "Whatever reason the Legislature had for enacting Enterprise Zone credits those reasons fail in light of reality." *AA, p. 186* (citing August 1995 committee report). While more recent studies reveal the efficacy of hiring credits, which "appear to be effective in increasing economic activity within smaller geographic area – such as within metropolitan regions,"[5] the critical point is that the FTB's opinion on the Act's efficacy should have no impact whatsoever on its claimed statutory authority to nullify agency certification determinations.

In its Opening Brief before this Court, the FTB disparages Enterprise Zone agencies as functioning more like a "trade group" than an independent auditing agency. But the question of *statutory construction* presented in this case is whether the Legislature could reasonably have believed that it struck a proper balance between its primary goal of encouraging the hiring of disadvantaged workers and its subsidiary concern over the risk of fraud or mistake by delegating responsibility for certifying the qualified status of hired employees to the EDD and local agencies. Clearly the Legislature could reasonably have believed that delegating responsibility to these expert agencies would provide sufficient protection against the risk of fraud or mistake while

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[5] *Dicon's Request for Judicial Notice on Appeal, Exh. A* (*An Overview of California's Enterprise Zone Hiring Credit*, Prepared for Assembly Comm. on Revenue and Taxation, Legislative Analyst's Office (Dec. 2003), http://www.lao.ca.gov/2003/ent_zones/ezones_1203.htm).

also preventing unnecessary incentive dilution. The voucher system, as construed by the Court of Appeal and Dicon, makes the certification process relatively inexpensive, predictable, and "user friendly," especially in comparison to the burdens that would arise if those seeking hiring credits were exposed to the risk of *de novo* reconsideration by the FTB years after completing the voucher process.

Further, the Legislature may reasonably have believed that its statutory goal of encouraging the hiring of disadvantaged workers through the hiring-credit incentive system would be enhanced by delegating decisional authority to certifying agencies with expertise and sensitivity in evaluating eligibility for participation in the covered programs. The FTB, by its own admission, lacks expertise in determining eligibility for jobs and economic assistance programs. Cal. Franchise Tax Board, summary analysis of Sen. Bill No. 2023 (1995-1996 Reg. Sess.) Sept. 6, 1996, as amended Aug. 31, 1996, p. 6.

The FTB's lack of sensitivity and expertise is evidenced by its recent attempts to usurp the certifying agencies' role in evaluating the qualified status of hired workers. At the time the FTB reviewed Dicon's vouchers, the FTB interpreted the Act as if it had not been amended in 1994. The FTB denied vouchers to those hiring employees eligible to participate, but who did not actually participate, in a specified job-benefit programs. *Request for Judicial Notice on Appeal ("Jud. Not."), Exh. D, p. 5; Exh. E, pp. 3-6.* The FTB's position is flatly inconsistent with the plain language of the Act, which, as described above, was amended in 1994 to define a qualified employee to include "[a]n individual who is *eligible for* services under the federal Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.) and who is receiving, *or eligible to receive*, subsidized employment, training or services funded by the federal Job Training Partnership Act." Remarkably, the FTB interpreted "or" to mean

"and" by rejecting vouchers for hired workers unless they are both eligible for an actually participate in a covered program. The FTB's "interpretation" was recently rejected by the State Board of Equalization, which noted that "enrollment [in the JTPA] is not required in order for an individual to be a qualified employee; R&TC section 23622.7, subdivision (b)(4)(A)(iv)(I), requires only that an individual be eligible for services under the JTPA." *The Matter of the Appeal of Deluxe Corp.*, State Bd. of Equalization Case No. 297128, Slip Op. p. 5, n.6, 2006 Cal. Tax Lexis 432 (Dec. 12, 2006). The FTB's interpretation reflects an apparent desire to do that which only the Legislature may do – gut or repeal the statutory right to hiring credits.

The FTB's lack of expertise and sensitivity was also evident when it construed the term "eligible" in an absurdly narrow manner by again interpreting "or" to mean "and." Section 1603 of the JTPA (29 U.S.C. §1501 et seq.) expressly provides that an individual may be eligible for JTPA services if he or she is "economically disadvantaged" **or** faces "serious barriers to employment." The FTB, however, has taken the position, in its auditing role, that an employee who faces "serious barriers to employment" at the time of hiring is not eligible for JTPA benefits unless that employee is *also* economically disadvantaged. *Jud. Not., Exh. B, p.11, Exh. C, pp. 3, 6-9.* By doing so, the FTB exhibits both a lack of sensitivity and expertise to the issues considered by the statutorily-authorized certifying agencies, and betrays an institutional bias that the Legislature wisely sought to avoid by delegating decision-making authority to the certifying agencies.

4. *De novo* FTB review would subvert the statutory incentive for hiring disadvantaged workers

The statutory incentive for hiring disadvantaged workers would be diluted by exposing Enterprise Zone employers to the risk that agency

certification determinations might be undone years later by FTB auditors simply because the FTB disagrees with discretionary determinations made by the certifying agencies. Indeed, the FTB's conduct in this case illustrates the risk posed by FTB nullification-by-audit and the likelihood that exposing taxpayer employers to such risks would impair the statutory incentive.

Dicon sought agency certification of its hired workers' qualified status in November 2003. Almost three years later, in October 2006, the FTB notified Dicon that it rejected vouchers worth over $1 million. The FTB informed Dicon the documentation supporting these vouchers, which had been in the local agency's possession, were inadequate. Dicon was notified that it would have to submit additional documentation to support the rejected vouchers. This notification, however, came long after Dicon could do anything about it. By the time the FTB notified Dicon in October 2006, Dicon had no access to additional documentation necessary to support hiring credits earned in the year ending March 31, 2001.

Dicon's inability to obtain additional documentary support for hiring credits earned in the year ending March 31, 2001, could not have been surprising to the FTB because (1) the taxpayer-employer is required *only* to maintain copies of its vouchers – *not* the supporting documentation (nor additional documentation not required by the certifying agency), as specified in §23622.7(c); and (2) employers lack access to the type of personal and financial documentation that might provide further verification that a (by now former) employee suffered from a disadvantaged economic condition or substantial impediment to employment opportunities at the time of hiring.

This type of documentation is highly confidential to the employees and is therefore not within the employer's control years after the voucher application has been submitted. Indeed, the type of personal financial

information necessary to support a voucher application is protected by the employee's right to privacy under the California Constitution, and it is therefore clearly outside the scope of the employer's control years after a voucher application has been submitted to the local agency.[6]

The FTB's interpretation would expose employers who have already obtained vouchers to the risk of denial years later. This risk would undermine the hiring incentive because employers typically lack access to supporting, privacy-protected documentation that had not been submitted to or required by the certifying agency when the voucher's were issued.

5. The Legislature took additional precautions against the risk of fraud or mistake

The reasonableness of the Legislature's chosen method for certifying a hired worker's qualified status is further supported by other precautions that it took to protect against the risk of fraud or mistake. The Legislature subjected the certifying agencies to DHCD and EDD regulation and audit. The Act expressly provides that (1) EDD may provide preliminary screening and referral to the certifying agency and shall develop a form for this purpose; and (2) DHCD shall develop regulations governing the issuance of certificates by local agencies. *Rev. & Tax. Code §23622.7(c).* The Legislature also subjected the certifying agencies to DHCD audit. *Gov. Code § 7076.1.* In that manner, the Legislature expressly delegated to DHCD and EDD, but not the FTB,

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[6] Personal financial information is protected by California's Constitutional "right to privacy." *Teamsters Local 856 v. Priceless, LLC*, 112 Cal.App.4th 1500, 1514 (2003) ("Our Supreme Court has recognized financial affairs as an aspect of the personal right to privacy"), citing *City of Carmel by the Sea v. Young*, 2 Cal.3d 259, 268 (1970) (holding that "ones personal financial affairs" are "an aspect of the zone of privacy which is protected by the Fourth Amendment and which also falls within that penumbra of constitutional rights into which the government may not intrude").

statutory responsibility for regulating the local agencies making certification decisions.

DHCD, as the State agency primarily responsible for regulating the local agencies, has actively regulated the process to assure compliance with the law. DHCD regulations require that each Enterprise Zone (or a third party designated by the Zone) create and maintain a vouchering plan containing policies and procedures for operating a vouchering program. *25 CCR §8463(a).* These policies and procedures must guarantee compliance with state law, expressly including *Rev. & Tax. Code* §23622.7. *25 CCR §8463(a)(1).* Consequently, a taxpayer-applicant seeking a voucher is required "to provide [the certifying agency with] documentary evidence to substantiate that the employee for whom a voucher is requested satisfied immediately preceding the commencement of employment, the requirements of subdivision (b)(4)(A)(iv) of Revenue and Taxation Code Sections 17053.74 or 23622.7 as a qualified employee." *25 CCR §8463(a)(2).* The range of documentation necessary to establish an employee's qualification is set forth by DHCD regulation in great detail at *25 CCR §8466.* All documentary evidence supporting the application must be kept confidential and maintained by the administering agency for at least five years. *25 CCR §8463(a)(3).* The agency's compliance with these regulations is subject to DHCD (not FTB) audit. *Gov. Code § 7076.1; CCR §8463(d).*

II. A VOUCHER ESTABLISHES A WORKER'S QUALIFIED STATUS AS A MATTER OF LAW, ABSENT AFFIRMATIVE EVIDENCE THAT THE ISSUING AGENCY ABUSED ITS DISCRETION

A. The Act Can Be Harmonized With The FTB's General Powers By Presuming The Accuracy Of Vouchers Unless Affirmatively Shown To Be An Abuse Of Discretion

The overriding purpose of statutory construction is to ascertain "the intent of the Legislature," thereby effectuating the "purpose of the law." *Dyna-Med, Inc. v. Fair Employment & Housing Comm.*, 43 Cal.3d 1379, 1386-1387 (1987). In doing so, "[t]he words of the statute must be construed in context, keeping in mind the statutory purpose, and statutes or statutory sections relating to the same subject must be *harmonized*, both internally and with each other, to the extent possible." *Id.* (emphasis added). In this case, the Legislature's clearly expressed intention to delegated discretionary decision-making authority to the expert agencies identified in Section 23622.7(c) must be *harmonized* with the FTB's general statutory authority to confirm the accuracy of tax returns. That is precisely what the Court of Appeal did.

The specific, discretionary authority delegated to the certifying agencies under the Act can be harmonized with the FTB's general authority by restricting the FTB's role in confirming the accuracy of properly-issued vouchers. Instead of construing the FTB's general auditing powers as authorizing it to make its own, independent, *de novo* determination of a worker's qualified status – thereby nullifying the agencies' specifically-delegated, discretionary authority -- the FTB's general authority must be limited to avoid such a conflict. That conflict is averted by recognizing that the FTB has authority to reject vouchers only upon an affirmative showing that the agency determination was an abuse of discretion. That construction preserves the Legislature's clearly expressed intent to vest expert agencies with

controlling discretionary decision-making authority, while maintaining the FTB's general authority to (1) prevent demonstrable fraud through affirmative evidence and (2) correct clearly erroneous agency determinations that cannot be justified by recourse to the agency's discretionary authority. By so limiting the FTB's general authority, the Court would harmonize the Legislature's specific intention with the FTB's general auditing authority.

1. The abuse of discretion standard honors legislative intent to delegate discretion to certifying agencies

There is no question that the Legislature intended to delegate discretionary authority to the certifying agencies. The delegation of decision-making authority to the certifying agencies is expressly stated in Section 23622.7(c). The type of decisions that certifying agencies are called upon to make often require exercise of judgment – *i.e.*, discretion. This legislative delegation of discretionary authority must be respected.

Courts have substantial experience in protecting legislative delegations of discretionary authority. When the Legislature delegates discretionary authority to administrative agencies, courts honor that delegation by applying an abuse of discretion standard on judicial review (unless the agency determination implicates fundamental vested rights). *Strumsky v. San Diego Co. Employees Retirement Assoc.*, 11 Cal.3d 28, 31-32 (1974); *Topanga Assoc. for a Scenic Community v. Co. of Los Angeles*, 11 Cal.3d 506, 515 (1974). The abuse of discretion standard protects discretionary determination, but only to the extent they do not exceed the bounds of reasonableness: "Abuse of discretion is established if the agency has not proceeded in a manner required by law or if the determination or decision is not supported by substantial evidence." *Laurel Heights Improvement Assoc. v. Regents of the Univ. of California*, 47 Cal.3d 376, 392 (1988). The reviewing trial court may not, therefore, substitute its own

judgment for that of the agency, and it "must resolve reasonable doubts in favor of the administrative findings and decision." *Id.* at 393.

The same rationale applies to the legislative delegation of discretionary authority to the certifying agencies. If the FTB rejects the an agency's certification decision and the taxpayer files suit, the judiciary must respect the Legislature's delegation of discretionary authority to the certifying agency. The agency determination must stand, despite the FTB denial, unless the FTB can affirmatively demonstrate that the agency abused its discretion. A standard less deferential to the certifying agency would undermine the legislative delegation of discretionary authority.

2. The Act implies that a voucher demonstrates a worker's qualified status

The Court of Appeal's determination that vouchers are prima facie evidence of a worker's qualified status is necessary to effectuate legislative intent. The substance and structure of the Act's hiring-credit provision requires that, once the Enterprise Zone employer has met its burden of proving a worker's qualified status to a certifying agency, the burden of rebutting that agency determination must be borne by the FTB.

The Court of Appeal based its ruling on several factors relating to the substance, structure and legislative history of the Act. *Slip Op., pp. 11-13. First*, the Act expressly limits the employer's affirmative obligations to (1) obtaining a voucher from a statutorily-identified certifying agency and (2) presenting the voucher to the FTB upon its request. *Slip Op., pp. 11-12.* If more was required of the employer – such as maintaining access to supporting documentation, whether submitted to the agency or not – the statute would not have limited the employer's obligation to maintaining only the voucher. Indeed, if the employer remained responsible for affirmatively proving a

worker's qualified status to the FTB's satisfaction, then the statutory duty to maintain only the voucher would be a trap for unsuspecting employers, effectively lulled into believing that their burden of proving a worker's qualified status ends upon receipt of an agency-issued voucher.

Second, the type of documentation necessary to demonstrate a worker's qualified status is not ordinarily within the employer's custody or control – especially during an audit that may occur years later, often after the worker has moved on. *Slip Op., p. 12.* During the voucher-application phase, when the employer at least has access to the worker and can request documentation necessary to demonstrate the worker's qualified status, the certifying agency can request documentation that the employer is in a much better position to obtain. But years later, when the worker is not likely to still be employed, the employer is in no position to obtain additional documentation that the FTB considers critical but the certifying agency did not. Fundamental fairness dictates that the time for requiring the production of supporting documentation is during the vouchering process, when the employer has an opportunity to obtain documentation from the worker, not years later after a voucher has been issued and the employee has left.

Third, privacy concerns also weigh in favor of construing the employer's limited document-retention obligation under the Act as evidencing legislative intent to treat the voucher as presumptively dispositive. *Slip Op., p. 12.* Section 23622.7(c) plainly requires the employer to maintain only the voucher to support the "qualified employee" element for obtaining a hiring credit. The employer is not required to maintain files of private employee documents for use if the FTB later decides to challenge a voucher. That is important because the type of documents that would demonstrate a worker's qualified status often reveal qualifying conditions that are potentially

embarrassing and almost always of a private nature, such as documents establishing limited literacy, criminal convictions, economic hardships and other indicia of disadvantage that implicate privacy interests. *Id.* Indeed, the FTB was properly mindful of such privacy concerns when it drew the Legislature's attention to this attribute of the vouchering process:

> "The vouchering process serves numerous functions for all parties affected, including the taxpayer, FTB, and DHCD, such as: [¶] . . . [¶] 3. Minimizes intrusiveness into the employee's personal life and provides confidentiality for the employee since the agency that administers the public assistance program is the one that issues the voucher. [¶] 4. Allows the employer (taxpayer) to retain less documentation to support a claim that an employee is a 'qualified employee.'" Cal. Franchise Tax Board, analysis of Sen. Bill No. 1097 (2003-2004 Reg. Sess.) Aug. 18, 2004, as amended July 27, 2004, p. 3.

Fourth, subjecting Enterprise Zone employers to the risk that vouchers issued by certifying agencies may be rejected years later during the course of an FTB audit will "[r]educe the employer's confidence in receiving the tax credit," thereby undermining the Act by creating "a disincentive to hiring a disadvantaged worker." *Slip Op., p. 13.* Indeed, the FTB emphasized to the Legislature that one advantage of the Act's certifying procedure is that it provides the employer an "up-front verification process," implying that the early determination of a worker's qualified status is a benefit to employers that enhances the Act's hiring incentive:

> "The vouchering process serves numerous functions for all parties affected, including the taxpayer, FTB, and DHCD, such as: [¶] . . . [¶] 2. Provides an up-front verification process for taxpayers regarding the determination of whether a potential employee is a 'qualified employee.'" Cal. Franchise Tax Board, analysis of Sen. Bill No. 1097 (2003-2004 Reg. Sess.) Aug. 18, 2004, as amended July 27, 2004, p. 3.

Finally, the FTB advised the Legislature that, by delegating decision-making responsibility to certifying agencies, the Act would protect the FTB from (1) the administrative burden of issuing vouchers and (2) the increased workload and cost of gaining expertise in the local business and employment issues necessary to assess eligibility to participate in covered programs. *Slip Op., p. 13.* As the Court of Appeal recognized, the "FTB informed the legislature that local agencies responsible for issuing vouchers were familiar with matters involving certification – one of the arguments Dicon makes in support of a voucher's prima facie value." *Id.* As a result, the FTB told the legislature that it intended to direct all inquiries about vouchers to the certifying agencies:

> "Although [FTB] does not administer the determination and certification of employees as eligible under the jobs programs criteria, [FTB] staff is required to explain the criteria in forms and instructions and respond to taxpayer inquiries regarding the qualification and certification of employees. Thus, [FTB] staff is concerned that undefined terms, such as 'economically disadvantaged individual' and 'dislocated worker,' could cause disputes regarding whether an individual is a qualified employee. [¶] However, Trade and Commerce Agency and EDD staff have indicated that these definitions are understood by those familiar with the TJTC [Targeted Jobs Tax Credit], JTPA, and GAIN programs and those responsible for certifying the employees. [¶] If questions regarding these definitions arise, [FTB] would refer all taxpayer questions regarding determination and certification of employees to the certifying agencies. This would likely increase the workload for those agencies." Cal. Franchise Tax Board, summary analysis of Sen. Bill No. 2023 (1995-1996 Reg. Sess.) Sept. 6, 1996, as amended Aug. 31, 1996, p. 6.

B. While The Act Limits The Taxpayer-Employer's Burden of Production, It Does Not Remove Its Burden of Persuasion

1. The burden of persuasion lies with the taxpayer

The FTB argues that the Court of Appeal's ruling violates the traditional rule imposing the "burden of proof" on taxpayers by ruling that vouchers are prima facie evidence that a hired worker is a qualified employee. *Opening Brief, p. 8.* In making its argument, however, the FTB improperly uses the term "burden of proof" to mean both a burden of persuasion and a burden of production. If the term "burden of proof" is properly understood to mean only a burden of persuasion, it is clear that the Court of Appeal's ruling did not shift or otherwise reallocate that burden.

The FTB objects to the Court of Appeal's holding that if the taxpayer meets its burden of production by making a prima facie case that the hired workers were "qualified employees," the burden of production shifts to the FTB. That shifting of the burden of production is what happens in any case where the party with the burden of persuasion produces evidence sufficient (as a matter of substantive law) to make a prima facie case. The FTB's argument to the contrary is based on its improper usage of the term "burden of proof" to encompass burdens of both persuasion and production.

The term "burden of proof," as employed by the FTB, is ambiguous because it is used to describe two very distinct concepts. The first concept is "burden of persuasion," which "is the notion that if the evidence is evenly balanced, the party that bears the burden of persuasion must lose." *Director, Office of Workers' Compensation Programs v. Greenwich Collieries*, 512 U.S. 267, 272 (1994). Burden of persuasion is the concept that is usually denoted by the phrase "burden of proof" and, in California and other jurisdictions, this is the correct use of the phrase "burden of proof." *Id.* at 273 (citing *Powers v. Russell*,

30 Mass. 69, 76-77 (1833) (L. Shaw, C.J.) ("the party whose case requires the proof of [a] fact, has all along the burden of proof")); *Sargent Fletcher, Inc. v. Able Corp.*, 110 Cal.App.4th 1658, 1667 (2003)(California uses "burden of proof" to mean burden of persuasion).

The second concept is "burden of production," which is "a party's obligation to come forward with evidence to support its claim." *Director*, 512 U.S. at 272 (citing J. Thayer, EVIDENCE AT THE COMMON LAW 355-384 (1898). While the *burden of persuasion* does *not* shift, the *burden of production* shifts "once the party with this burden establishes a prima facie case." *Id.* at 273 (citing *Powers*, 30 Mass. at 76); *Sargent Fletcher*, 110 Cal.App.4th at 1168 ("once [the party bearing the burden of persuasion] produces evidence sufficient to make its prima facie case, the burden of producing evidence *shifts* to the other party to refute the prima facie case").

The Court of Appeal ruled that a taxpayer-employer's *burden of production* shifts to the FTB upon production of a voucher issued by a certifying agency because the voucher is prima facie evidence of the hired worker's qualified status. This is not a shifting of the burden of persuasion. The taxpayer always bears the burden of persuasion in a tax-refund case involving hiring credits, just as a plaintiff in ordinary civil litigation generally bears the burden of persuasion (except as to affirmative defenses). But if the taxpayer, like an ordinary civil plaintiff, presents evidence sufficient to make a prima facie case, the burden of production shifts to the FTB, as it shifts to a defendant in an ordinary civil case. *Aguilar v. Atlantic Richfield Co.*, 25 Cal.4th 826, 845-847, 849, 850-851 (2001).

Here, the taxpayer-employer, as the party with the burden of persuasion, bears the burden of proving every element of its claim. But, as for the qualified-employee element of the claim, the Court of Appeal held that the

taxpayer-employer meets its burden of production by presenting a voucher issued by an authorized agency. The determination that a voucher is sufficient evidence to establish the taxpayer's prima facie case is a determination based on substantive law, Section 23622.7(c). *Cf. Aguilar*, 25 Cal.4th at 851-852, 856-857 (explaining that the *type of evidence* necessary to make a prima facie case is a function of the underlying substantive law); *Ghirardo v. Antonioli*, 8 Cal.4th 791, 800 -801 (1994) (recognizing a fact-to-law application that requires "the exercise judgment about the values that animate legal principles" presents a "question [that] should be classified as one of law and reviewed de novo"). Thus, the voucher's prima facie value is based on a construction of the Act, including its explicit delegation of decision-making authority to the certifying agencies. The Court's determination that the voucher is prima facie evidence of a worker's qualified status is based on Section 23622.7(c), which states that that the taxpayer-employer meets its statutory burden of demonstrating an employee's qualified status by seeking and obtaining a voucher from an authorized certifying agency and presenting that voucher to the FTB.

The statute thereby defines the scope of the taxpayer-employer's burden in establishing the qualified-employee element. By meeting that burden of production, the taxpayer shifts to the FTB the burden of producing evidence sufficient to establish that the certifying agency could not have issued a voucher without abusing its discretion. This movement of production burdens is governed by the underlying substantive law. It does not violate the rule in tax refund cases that taxpayers bear the burden of persuasion.

2. None of the policy factors asserted by the FTB weigh against the prima facie value of vouchers

The FTB relies upon the "purposes" of the burden of persuasion as support for its contention that vouchers cannot be deemed to satisfy the

taxpayer's prima facie burden of proving the qualified status of its employees. *Opening Brief, p. 9.* The FTB cites this Court's decision in *Morris v. Williams*, 67 Cal.2d 733, 760 (1967), for the proposition that "as a matter of policy the person having the power to create, maintain and provide the evidence should carry the burden of proof." *Opening Brief, p. 9.* None of these three factors support the FTB's position.

First, the taxpayer-employer does not "create" the documentation necessary to establish that hired workers are qualified employees as defined under the Act. The employer must typically obtain documentary evidence supporting the employee's qualified status from the employee. *Second*, the documentation supporting the employee's qualified status is not required to be maintained by the taxpayer-employer. Once the supporting documentation is provided to the certifying agency, the statute expressly limits the employer's obligation to maintain documentation by requiring only that it maintain the voucher – not supporting documentation. As the FTB itself has recognized, this limitation on the employer's duty to maintain documentation serves two positive functions – it "minimizes intrusiveness into the employee's personal life and provides confidentiality for the employee since the agency that administers the public assistance program is the one that issues the voucher" and it "allows the employer (taxpayer) to retain less documentation to support a claim that an employee is a 'qualified employee,'" which reduces both the burden on the taxpayer-employer and the privacy risks created when employers maintain files with highly-confidential employee information. *Slip Op., p. 12* (quoting Cal. Franchise Tax Board, analysis of Sen. Bill No. 1097 (2003-2004 Reg. Sess.) Aug. 18, 2004, as amended July 27, 2004, p. 3). Thus, by statutory design, the taxpayer-employer is not the person responsible for maintaining the evidence necessary to prove the employee's qualified status.

The *third* factor, that the person having the power to provide the evidence should carry the burden, is likewise inapplicable because the taxpayer-employer has the burden of providing the supporting evidence only to the certifying agency – not to the FTB. Again, by statutory design, the taxpayer-employer is relieved of the burden of providing anything to the FTB except the voucher.

Finally, the FTB contends that vouchers cannot be deemed prima facie evidence of qualified status because doing so would encourage taxpayer-employers to discard evidence supporting their employees' qualified status. *Opening Brief, pp. 10-11 & n. 5.* Building on that theme, the FTB argues that "[i]f the records [maintained by the taxpayer-employer years after receiving a voucher] are so deficient that a proper audit cannot be made, the defaulting record-keeping taxpayer should bear the consequences." *Id., p. 11 n.5.* Again, however, the FTB protests against an incentive created by legislative design. The Legislature plainly intended to discourage taxpayer-employers from maintaining sensitive records documenting the disadvantaged status of its qualified employees. That is why the statute requires taxpayer-employers to maintain only the vouchers, not the supporting documentation.

C. The Ban On Prepayment Tax Litigation Is Not Violated By According Prima Facie Weight To Vouchers

The FTB argues that, if vouchers are given prima facie weight, taxpayers will be permitted to file lawsuits seeking to enjoin the payment of taxes before they are paid. The argument makes no sense. Article XIII, Section 32 of the California Constitution flatly bars the filing of legal actions seeking to enjoin the assessment or collection of taxes before payment of such taxes: "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of

any tax." Thus, no matter how meritorious a taxpayer's claim may be, no matter how strong or one-sided the evidence supporting the claim may be, a lawsuit simply cannot be filed before payment of the disputed tax.

The FTB argues that (1) the Court of Appeal's holding that vouchers are prima facie evidence of a hired worker's qualified status applies to FTB auditors during the audit process, so (2) if auditors do not recognize the prima facie weight of a voucher during a pre-payment audit, the taxpayer may file a lawsuit seeking to prevent or enjoin the collection of taxes based on the disputed tax credit. *Opening Brief, p. 29.* The simple and dispositive response is that no such action may be filed given the Constitutional ban against pre-payment litigation, a flat rule that does not depend upon the merits of the taxpayer's challenge. Thus, according a voucher prima facie evidentiary weight does not allow taxpayer to challenge the FTB's audit determination before payment of taxes.

D. The *De Novo* Nature Of Tax Refund Actions Is Not Compromised By According Prima Facie Weight To Vouchers

A post-payment action for a tax refund is tried in the superior court on a *de novo* basis, not as an administrative writ. *Opening Brief, p. 30-31.* Thus, according to the FTB, the question of whether a hired worker meets the qualified-employee requirement is an issue that must be decided on a *de novo* basis at trial, without any deference to the certifying agency's determination. *Id.* Contrary to the FTB's assumption, according prima facie weight to the voucher, to effectuate legislative intent, does not compromise the *de novo* nature of a tax refund action.

"A prima facie showing is one that is sufficient to support the position of the party in question. (Cf. Evid.Code, § 602 [stating that a 'statute providing that a fact or group of facts is prima facie evidence of another fact establishes

a rebuttable presumption'].) No more is called for." *Aguilar*, 25 Cal.4th at 850-851. The prima facie weight accorded to a voucher is not inconsistent with the *de novo* nature of the tax refund action. The taxpayer bears the burden of persuasion that a hiring credit is valid, a burden that requires the taxpayer to establish that the hired worker is a "qualified employee." The Court of Appeal has merely decided, as a matter of substantive law under the Act, that the taxpayer meets its prima facie burden by presenting a voucher. The question of whether the evidence provided by a party is sufficient to meet its prima facie burden of production is a matter of substantive law. *Aguilar*, 25 Cal.4th at 851-852, 856-857 (holding that sufficiency of evidence to support antitrust conspiracy claim is based on an assessment of substantive antitrust law). Thus, whether a taxpayer's prima facie case is deemed to be established by presentation of a voucher, the hired worker's testimony, or other documentation, presents a question of substantive law – the resolution of which does not render the superior court trial anything other than a de novo adjudication.

The Court of Appeal properly ruled that the taxpayer-employer satisfies its burden of producing evidence to support the qualified-employee element by submitting a voucher issued by a certifying agency. By deeming the voucher prima facie evidence that the hired worker is a qualified employee, the Court of Appeal honors the Legislature's clearly expressed intent to (**1**) delegate discretionary decision-making authority to the certifying agency, whereby its determination is deemed presumptively controlling unless rebutted by affirmative evidence demonstrating that it would be an abuse of discretion to find the worker to be a qualified employee; and (**2**) relieve the taxpayer-employer from the burden of maintaining the documentation necessary to prove affirmatively the hired worker's qualified status. The Court

of Appeal, by finding that vouchers satisfy the taxpayer's prima facie burden based on the underlying substantive law, did nothing to compromise the *de novo* nature of tax refund disputes.

III. THE FTB WAIVED ANY RIGHT TO CONTEST REVERSAL OF THE DEMURRER

The FTB's Opening Brief states, in its conclusion, that the decision of the Court of Appeal must be vacated and the judgment of the trial court, granting the FTB's demurrer without leave to amend, must be affirmed. *Opening Brief, p. 34.* The request to affirm the trial court's demurrer, however, is improper because the FTB does not *argue* that the Court of Appeal erred in ruling that Dicon's Complaint states a viable claim or that it erred in its alternative holding that Dicon may amend its complaint to allege a viable tax refund claim. The FTB has limited its argument before this Court to an issue resolved by the Court of Appeal solely for purposes of guiding the parties and the trial court upon remand.

The sole issues raised in FTB's Petition for Review concerns the propriety of the Court of Appeal's holding that vouchers are prima facie evidence of a worker's qualified status. *Petition for Review, p. 1.* This ruling was independent from the Court of Appeal's separate holdings that (1) the Complaint stated a viable claim for a tax refund; and (2) even if it did not state a viable claim as alleged, Dicon demonstrated that it could file an amended complaint stating a viable refund claim. *Slip Op., p. 7.* The single issue raised in the Petition for Review – whether a voucher is prima facie evidence of a hired worker's qualified status – was not necessary to resolution of the appeal on the merits. Rather, the Court of Appeal addressed the issue solely to provide the trial court and parties with guidance upon remand. *Slip Op., p. 7.* Thus, the question presented for review has no impact on the Court of

Appeal's rulings that the Complaint stated a viable tax refund claim or, alternatively, the Complaint could be amended to do so.

The FTB, having failed to address the merits of these rulings in their Petition for Review or Opening Brief on the merits, has waived the right to challenge those rulings. Rules of Court, Rule 8.520(b)(3) ("briefs on the merits must be limited to the issues stated in [the petition for review or order of the Court specifying issues] and any issues fairly including in them"); *Tiernan v. Trustees of California State Univ. & Colleges*, 33 Cal.3d 211, 216 (1982) (holding that issues not argued are deemed waived). Consequently, no matter how the question presented is resolved by this Court, Dicon will have the right to proceed with its case in the trial court.

CONCLUSION

For these reasons, this Court must affirm the Court of Appeal's holding that vouchers are prima facie evidence of a hired worker's qualified status under the Act. But even if the Court were to reverse that ruling, the Court of Appeal's rulings that (1) Dicon has alleged a viable claim and, alternatively, (2) Dicon must be given the opportunity to allege a viable claim, are not implicated by this Petition for Review.

DATED: Feb. 15, 2010

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CERTIFICATE OF COMPLIANCE

The text of Plaintiff and Appellant's Answer Brief consists of 13,921 words as counted by the Microsoft Word version 2002 word-processing program used to generate the brief.

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PROOF OF SERVICE

Dicon Fiberoptics v. Franchise Tax Board
Case No. S173860

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 1875 Century Park East, 23rd Floor, Los Angeles, California 90067-2561.

On February 12, 2010, I served the following document(s) described as **ANSWER BRIEF** on the interested parties in this action as follows:

BY MAIL: By placing a true copy thereof in sealed envelopes addressed to the parties listed on the attached Service List and causing them to be deposited in the mail at Los Angeles, California. The envelopes were mailed with postage thereon fully prepaid. I am readily familiar with our firm's practice of collection and processing correspondence for mailing. It is deposited with the U.S. Postal Service on that same day in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing affidavit.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on February 12, 2010 at Los Angeles, California.

Sandy Palmieri

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