

No. S241471

In the Supreme Court of California

Michael McClain, Avi Feigenblatt, and Gregory Fisher,
Plaintiffs, Appellants and Petitioners,

vs.

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

After a Decision of the Court of Appeal
Second Appellate District, Division 2
Case Nos. B265011 and B265029

Affirming a Judgment of Dismissal Following
An Order Sustaining Demurrer Without Leave to Amend
Los Angeles County Superior Court, Case Nos. BC325272 and BC327216
Honorable John Shephard Wiley, Presiding

**APPLICATION TO FILE AMICUS CURIAE BRIEF AND BRIEF OF
AMICI LEAGUE OF CALIFORNIA CITIES AND CALIFORNIA
STATE ASSOCIATION OF COUNTIES**

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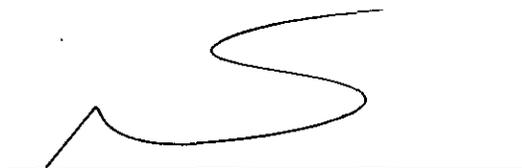
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**CERTIFICATE OF
INTERESTED ENTITIES OR PERSONS**

There are no entities or persons that must be listed in this certificate under California Rules of Court, rule 8.488.

DATED: April 12, 2018

**COLANTUONO, HIGHSMITH &
WHATLEY, PC**

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APPLICATION FOR PERMISSION TO FILE AMICUS CURIAE BRIEF

To the Honorable Chief Justice Tani Cantil-Sakauye:

Pursuant to California Rules of Court, rule 8.520(f), the League of California Cities (the "League") and the California State Association of Counties ("CSAC"), respectfully request permission to file the attached amicus curiae brief. This application is timely made within 30 days of the filing of the reply brief on the merits.

Counsel for the League and CSAC have reviewed the parties' briefs on file in this case and believe that additional briefing would be helpful to the Court. The League and CSAC have a substantial interest in this case because the local governments they represent are beneficiaries of the Bradley-Burns Uniform Sales and Use Tax and Transactions and Use Taxes, administered by the California Department of Tax and Fee Administration on a common basis for the State and all cities and counties. (Stats. 1955, ch. 1311; Rev. & Tax. Code, § 7200 et seq.) Although local government revenue streams vary, local sales and use tax revenue constitute a large fraction of city and county discretionary revenue, funding essential services for city and county residents, businesses and property owners. The League and CSAC therefore have an interest in the orderly administration of the state sales and use tax.

The League and CSAC take no position on the merits of Appellants' claim they are entitled to a refund remedy. Instead, the

League and CSAC write to provide a wider policy framework for deciding this case and, in the event the Court were to find a refund remedy appropriate, encourage the Court to write narrowly to avoid unintended consequences for the cities and counties who are not party to this case but might be affected by its outcome.

The League and CSAC believe the brief will aid this Court and respectfully request leave to file it.

IDENTITY OF AMICUS CURIAE AND STATEMENT OF INTEREST

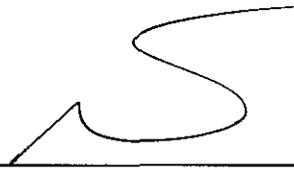
The League is an association of 474 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, comprised of 24 city attorneys from all regions of the state. The Committee monitors litigation of concern to municipalities and identifies those cases of state or national significance. The Committee has identified this case as having such significance.

CSAC is a non-profit corporation. The membership consists of the 58 California counties. CSAC sponsors a Litigation Coordination Program administered by the County Counsels' Association of California and overseen by the Association's Litigation Overview Committee, comprised of county counsels throughout the state. The

Litigation Overview Committee monitors litigation of concern to counties statewide and has determined that this case affects all counties.

DATED: April 12, 2018

**COLANTUONO, HIGHSMITH &
WHATLEY, PC**

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Counties

INTRODUCTION

Amici do not advocate for or against a refund remedy for those who bear the economic incidence of state sales taxes without bearing their legal burden. Instead, Amici write to limn the broader policy context in which the distinction between the legal and economic incidence of taxes arises and to encourage this Court to write narrowly should it find a refund remedy for those who bear the economic, but not legal, burden of a revenue measure, to avoid disrupting local government finance.

ARGUMENT

I. **THIRD-PARTY ECONOMIC INCIDENCE EXTENDS BEYOND SALES AND USE TAXES**

The distinction between the taxpayer who is legally obliged to pay sales taxes here and the consumers who bear the economic incidence of those taxes in most instances (*McClain v. Sav-on Drugs* (2017) 9 Cal.App.5th 684, 698 (*McClain*)) is not unique to the state sales tax. As the Court of Appeal observed, the division between the “legal taxpayer” and “economic taxpayer” is an inherent feature of the state sales tax law. (*Ibid.*) But this structure is not “peculiar” to the state sales tax. (*Ibid.*)

In fact, local governments obtain substantial funding for essential public services from revenue measures that follow similar models, such as hotel bed taxes and franchise fees. (*In re Transient*

Occupancy Tax Cases (2016) 2 Cal.5th 131 [San Diego TOT not incident on online resellers of hotel stays]); *Jacks v. City of Santa Barbara* (2017) 3 Cal.5th 248, 262 (*Jacks*) [Santa Barbara's franchise fee on electric utility passed through to customers not a tax for that reason alone].)

Local governments charge fees for a variety of franchise rights. (Cal. Municipal Law Handbook (Cont. Ed. Bar 2018) §§ 5.189–5.197, pp. 591–593 [discussing electrical, gas, water, video, and telephone franchises].) While franchisees bear the legal incidence of such fees (i.e., the legal duty to pay), consumers or ratepayers typically bear the economic incidence (i.e., cost). (E.g., *Jacks, supra*, 3 Cal.5th at p. 271.) Electrical utilities, for example, recover the cost of franchise fees by including the fee in their rates or as a separate item on bills. (*Id.* at pp. 266–267.) Retailers similarly recover sales taxes from their customers except, perhaps, on “sales tax holidays.” (*McClain, supra*, 9 Cal.App.5th at pp. 689, 692–693; see also *Loeffler v. Target Corp.* (2014) 58 Cal.4th 1081, 1093, 1103–1109 (*Loeffler*) [a separate “sales tax reimbursement” may be charged or the sales tax may be included in item's cost].)

Local business improvement district assessments that fund public facilities and services are similarly structured. (Sts. & Hy. Code, § 36600 et seq.; see generally *Inland Oversight Committee v. City of Ontario* (2015) 240 Cal.App.4th 1140, 1145 & fn. 4 (*Inland Oversight Committee*).) Local governments use business assessments to fund

facilities and services to aid businesses and create jobs. (Sts. & Hy. Code, § 36601, subd (b).)

The tourism marketing district described in *Inland Oversight Committee* is an example. Formed to market and promote the hotel industry and tourism, hotel marketing districts are financed by an assessment on lodging businesses authorized to pass it through to their guests, which typically must show it on hotel bills if they do. (*Inland Oversight Committee, supra*, 240 Cal.App.4th at p. 1141, citing Sts. & Hy. Code, § 36632; e.g., San Diego Mun. Code, § 61.2510, subd. (a)(8); see also Pasadena Mun. Code, § 4.101.130.)¹

Local governments also require third parties to collect taxes and fees legally incident on customers of those businesses. The legal incidence of a utility user tax, for example, falls on utility users, not suppliers. (*City of Modesto v. Modesto Irrigation Dist.* (1973) 34 Cal.App.3d 504, 505–506.) Yet, utility suppliers must collect the tax from their ratepayers and remit it to local governments. (*Ibid.*) Thus, an incidental but not insubstantial economic burden of the tax necessarily falls on utility suppliers which are often themselves exempt from the tax to reflect their contribution of services. (*Id.* at

¹ Amici request judicial notice of the municipal code sections cited in this brief in the accompanying Motion for Judicial Notice (“MJN”), dated April 12, 2018.

p. 508 [tax collection costs would exceed tax revenue without this means of tax collection].)

Transient occupancy taxes are similarly structured. (*In re Transient Occupancy Tax Cases* (2016) 2 Cal.5th 131 [hotel operators collect and remit transit occupancy tax levied on their guests].) So, too, was the tippler's tax. (*Scol Corp. v. City of Los Angeles* (1970) 12 Cal.App.3d 805 [retailers collect and remit tippler's tax levied on customers].)²

The Petition — as currently framed — asks the Court to fashion a tax refund remedy for circumstances unique to the state sales tax. Yet circumstances in which the legal and economic incidence of a tax do not coincide are not unique. Essential local revenue sources share the third-party tax structure of the state sales tax. Thus, the Court should be cognizant that a broadly worded opinion that embraces the tax refund remedy the Petition requests may unintentionally destabilize these local revenue sources.

² This charter city tax was found preempted by state alcohol excise taxes in another case of this era. (*Century Plaza Hotel Co. v. City of Los Angeles* (1970) 7 Cal.App.3d 616, 622–626.)

II. ECONOMIC INCIDENCE DOES NOT CONFER STANDING TO CHALLENGE A TAX

The distinction between the legal incidence of a tax (who bears the burden to pay it under the legislation imposing the tax) and the economic incidence of a tax (who ends up paying it after private transactions play out) is fundamental to tax law. (*Occidental Life Ins. Co. v. State Bd. of Equalization* (1982) 135 Cal.App.3d 845, 850 [“[u]nder California law the legal incidence and the economic burden are two separate and distinct concepts”], citation omitted.) As this Court recently noted in *Jacks*:

[A]ll that the City ultimately contends in this regard is that the economic incidence of a charge does not determine whether it is a tax. We agree. Valid fees do not become taxes simply because their cost is passed on to the ratepayers.

(*Jacks, supra*, 3 Cal.5th at p. 271.) Thus, this distinction underlies the Court’s standing jurisprudence.

Standing fundamentally “reflects a sensitivity to broader prudential and separation of powers considerations elucidating how and when parties should be entitled to seek relief.” (*Weatherford v. City of San Rafael* (2017) 2 Cal.5th 1241, 1248 (*Weatherford*)). “The issue of standing is determined by the courts as a matter of policy.” (*Chiatello v. City and County of San Francisco* (2010) 189 Cal.App.4th 472, 481 (*Chiatello*), quotation omitted.)

It has long been held that the legal incidence of a tax — and not its economic incidence — confers standing to challenge it. (*Torres v. City of Yorba Linda* (1993) 13 Cal.App.4th 1035, 1042 (*Torres*) [payment of sales tax did not give non-residents standing to challenge redevelopment project because legal incidence was on retailer]; *Cornelius v. Los Angeles County etc. Authority* (1996) 49 Cal.App.4th 1761, 1777–1778 (*Cornelius*) [sales and gas taxes did not give contractor standing to challenge affirmative action program because legal incidence was on retailer and gasoline distributor]; *Chiatello, supra*, 189 Cal.App.4th at p. 480 [non-payor of tax on partnership distributions lacked standing to challenge it]; see also *In re Transient Occupancy Tax Cases, supra*, 2 Cal.5th a 139 [hotel bed tax not incident on online resellers of hotel stays].)

The Court reaffirmed this standing rule in two recent cases. (*Jacks, supra*, 3 Cal.5th at pp. 256, 271 [taxpayer standing to challenge a local government revenue measure in traditional mandate]; *Weatherford, supra*, 2 Cal.5th at pp. 1244–1245, 1252 [taxpayer standing to challenge a local government expenditure under Code Civ. Proc., § 526a].)

In *Weatherford*, this Court rejected an interpretation of Code of Civil Procedure section 526a³ — a legislative grant of standing broader than would exist otherwise — that would confer “unrestricted” taxpayer standing. (2 Cal.5th at p. 1251.) The Court

³ Unspecified section references are to the Code of Civil Procedure.

instead held section 526a required that the plaintiff had, at a minimum, “paid or is liable to pay, to the defendant locality a tax assessed on the plaintiff by the defendant locality.” (*Id.* at p. 1252.) Simply visiting the community and buying a packet of gum subject to sales tax was not sufficient to confer standing to challenge the municipality’s policies.

Yet, *Weatherford* also recognized local government tax structures may be relevant in determining taxpayer standing under section 526a. (2 Cal.5th at p. 1252 [“local governments’ tax structures might shed some light on the consequences of a requirement that taxes be directly assessed against a plaintiff”].) *Jacks* also accepted that courts look to a revenue measure’s legal incidence, not its economic incidence, to determine standing. (3 Cal.5th at p. 271.)

The Court however has not definitively outlined the contours of taxpayer standing. (*Weatherford, supra*, 2 Cal.5th at pp. 1256–1257 (conc. opn. of Kruger J.) [noting § 526a could be read to confer standing on anyone who indirectly pays a local sales tax].) The Legislature has some role to play in doing so. (*Id.*, at p. 282, conc. opn. of Cantil-Sakauye, C.J.) In the century since section 526a was adopted, tax law and government finance have become exceedingly complex. (*Loeffler v. Target Corp.* (2014) 58 Cal.4th at pp. 1123, 1127 (maj. opn. of Cantil-Sakauye, C.J.) [sales tax is comprehensive and exceedingly complex]; *id.* at p. 1136 (dis. opn. of Liu, J.) [same];

Weatherford, supra, 2 Cal.5th at p. 1254. (conc. opn. of Cantil-Sakauye, C.J.) [examples of local and state revenue measures].)

Taxes and other revenues are, of course, the “lifeblood of modern government” and it is therefore a legal truism that special care must be taken in tax litigation so essential revenues are “interfered with as little as possible.” (*Chiatello, supra*, 189 Cal.App.4th at pp. 475, 492.) It has long been understood that even temporary interference “may derange the operations of government, and thereby cause serious detriment to the public.” (*Id.* at p. 489, fn. 7, quoting *Dows v. City of Chicago* (1870) 78 U.S. 108, 110, opn. of Field, J.)

Amici therefore urge the Court to write narrowly and with attention to this broader context if it identifies a refund remedy for those who allegedly bear the economic incidence of a tax, but not the legal obligation to pay it. If not, the Court risks inadvertently conferring universal standing if it eliminates the legal incidence requirement in this case or elides the distinction between the legal and economic incidences of revenue measures.

Courts have broadly relied upon this Court’s sales tax remedy jurisprudence to find standing for challenges to local government revenue measures. In *Sipple v. Hayward* (2014) 225 Cal.App.4th 349, 358–363 (*Sipple*) for instance, the Court of Appeal held a cellphone company had standing to pursue a tax refund from a large group of cities and two counties for the benefit of a class of its customers who

had prevailed in a federal class action litigated outside this state in the absence of local taxing agencies. By conferring standing on a business to sue for refund for a tax it did not pay, *Sipple* acknowledged it was charting new territory. (*Id.* at p. 361 [no published case closely resembled the dispute at issue].) *Sipple*, nevertheless, broadly read this Court's state sales tax refund remedy cases as support for standing under what that court viewed as "unique circumstances" of the case. (*Id.* at p. 361, citing *Decorative Carpets, Inc. v. State Bd. of Equalization* (1962) 58 Cal.2d 252, 256.)

Taxpayer standing was also extended in *Andal v. Stockton* (2006) 137 Cal.App.4th 86 (*Andal*). There, three cell carriers challenged a fee the city levied on its customers. (*Id.* at p. 89.) Although the businesses had no duty to pay the fee, but merely to collect it, *Andal* found the fee's administrative burden on the businesses conferred standing to challenge it. (*Id.* at pp. 94–95.)

Thus, if the Court is inclined to fashion a consumer sales tax refund remedy, it should write so that its conclusion does not invite broad application to other third-party taxes, assessments and fees. As illustrated above, local revenue measures share the third-party tax structure present here. (*McClain, supra*, 9 Cal.App.5th at p. 698.) Should the legal incidence / economic incidence distinction underlying third-party tax structures be lost or obscured in the fashioning of a tax refund remedy here, lower courts may extend that analysis to other, local revenue and finance measures. (See

Howard Jarvis Taxpayers Ass'n v. City of Fresno (2005) 127 Cal.App.4th 914, 925 [courts adhere to the Supreme Court's conclusions even if dicta.] Courts may even find support for taxpayer standing in consumers who bear the economic, but not legal, burden of the Bradley-Burns Uniform Sales and Use Tax (Rev. & Tax. Code, § 7200 et seq.). (*Weatherford, supra*, 2 Cal.5th at pp. 1256–1257 (conc. opn. of Kruger J.) [noting this possibility].)

Yet the fiscal stability and orderly operation of local government require taxpayer standing be conferred only on those who bear the legal incidence of a levy. The alternative is universal standing and perpetual litigation. (Cf. *Western States Bankcard Assn. v. City and County of San Francisco* (1977) 19 Cal.3d 208, 217–218 [a levy's economic incidence is generally "passed down the commercial chain, link by link, until ... diffused in the pool of ultimate consumers"].)

Litigation costs will rise, too, if the Court erodes the rule that standing to challenge a tax requires one to bear its legal incidence. Courts warn of the potential for a "huge volume of litigation over the fine points of tax law [¶] ... [¶] that could threaten revenue collection and ability of government to plan for expenditure." (*Loeffler v. Target Corp., supra*, 58 Cal.4th at pp. 1130–1131.) This risk has been repeatedly recognized:

[T]he most obvious negative consequence of allowing legal challenges by persons lacking a direct financial

interest in the operation of a tax is the unacceptable risk of paralyzing the financial stability of local governments with a flood of lawsuits.

(*Chiatello, supra*, 189 Cal.App.4th at p. 476.)

A second policy consideration is grounded in studies that have shown taxpayer actions have the potential of being brought to, inter alia, improperly harass public officials with vexatious litigation, challenge policy decision, encourage governmental immobility and discourage community action. (*Chiatello, supra*, 189 Cal.App.4th at p. 496, citations omitted.) This possibility only increases if taxpayer standing is conferred to those who do not bear the legal incidence of a tax.

Consideration should be given to these possibilities.

(*Weatherford, supra*, 2 Cal.5th at p. 1252 [consideration given to consequences that will flow from Court's interpretation], quotation omitted.)

First, and foremost, the risk of a flood of litigation is real — not merely an abstract possibility. (See, e.g., *Creed-21 v. City of Wildomar* (2017) 18 Cal.App.5th 690, 697–698 (*Creed-21*) [documenting fee-seeking attorney's creation of shell corporations to file over a 100 lawsuits across the state]; *Torres, supra*, 13 Cal.App.4th at p. 1043 [similar reverse validation proceedings filed in multiple communities].) And this exposure is exponentially magnified by the prospect of massive tax refund class actions. (*Ardon v. City of Los*

Angeles (2011) 52 Cal.4th 241, 245 [allowing class claims for tax refunds]; *Sipple, supra*, 225 Cal.App.4th at p. 352 [tax refund class action filed against 115 cities and 2 counties].)

Second, the paralyzing effect of universal standing is not imaginary, as voter approval requirements limit local governments' ability to amend or increase revenue measures. (*Jacks, supra*, 3 Cal.5th at pp. 257–260 [challenge to electric franchise fee as alleged tax requiring voter approval, remanded for proof of a bona fide exchange of value; *California Cannabis Coalition v. City of Upland* (2017) 3 Cal.5th 924 [challenge to marijuana dispensary licensing fee as a general tax]; *Chiatello, supra*, 189 Cal.App.4th at p. 496 [noting voter approval requirements make the consequences from persistent challenges to local revenue sources even more problematic].)

Thus, if the Court identifies a refund remedy for those who bear the economic, but not legal, burden of a tax, Amici urge it to write narrowly to ensure that it does not inadvertently disrupt the orderly administration of local revenue measures and state sales tax.

III. LEGAL INCIDENCE IS A MATTER OF LAW; ECONOMIC INCIDENCE IS A QUESTION OF FACT REQUIRING EXPERT EVIDENCE

The economic incidence of a revenue measure is not a serviceable test of standing. Economic incidence analysis is complex and can diverge widely from the text of revenue legislation. (*City of San Diego v. Shapiro* (2014) 228 Cal.App.4th 756, 783, fn. 28, citing *Fulton Corp. v. Faulkner* (1996) 516 U.S. 325, 341–343 & fn. 7 (*Fulton Corp.*)). The U.S. Supreme Court stated the point in these terms:

It is well established that ‘the ultimate distribution of the burden of taxes [may] be quite different from the distribution of statutory liability’ [citation], with such divergence occurring when the nominal taxpayer can pass it through to other parties

(*Fulton Corp., supra*, 516 U.S. at p. 341.)

Courts discern the legal incidence of a revenue measure by applying the canons of construction to legislation, but economic incidence is a factual issue that will often be disputable. The U.S. Supreme Court has recognized, “courts as institutions are poorly equipped to evaluate with precision the relative [economic] burden of various methods of taxation.” (*Fulton Corp., supra*, 516 U.S. at p. 342.) Economic theory suggests the economic burden of a levy will vary from place to place and time to time based on the leverage

of buyers and sellers to particular transactions. (*Id.* at pp. 341–343 & fn. 7.) And such factual determinations present a potential for error. (*Id.* at p. 342.)

Exchanging a fixed standard that applies the ordinary rules of statutory construction for a factual free-for-all of competing expert opinion is a dangerous precedent. It injects uncertainty and unpredictability into local government finance. It also sets the stage for universal standing in a global economy where the economic incidence of a local levy could be dispersed throughout the country or the world.

Economic incidence therefore is simply not an adequate legal tool for determining standing to challenge local revenue and finance measures.

CONCLUSION

The distinction between the legal and economic incidence of revenue measures is fundamental to tax jurisprudence. Limiting standing to those who bear the legal incidence of the measures they would challenge allows standing to be determined readily as a question of law. Extending standing to those who claim to bear the economic incidence of a tax will create universal standing in many contexts (e.g., the buyer of a packet of gum discussed in *Weatherford*) and will make standing jurisprudence uncertain. This will destabilize local government finance, increase the risk of litigation, and make that litigation more costly to resolve. Accordingly, should

this Court identify a refund remedy for the plaintiffs here, Amici urge this Court to write narrowly so as not to destabilize local government finance.

DATED: April 12, 2018

**COLANTUONO, HIGHSMITH &
WHATLEY, PC**

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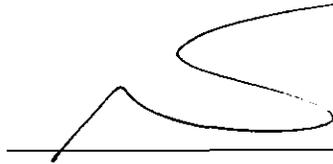
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California State Association of
Counties

CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.520(b) and 8.204(c), the foregoing Brief of Amici Curiae contains 3,132 words, including footnotes, but excluding the caption page, tables, Certificate of Interested Entities or Persons, the Application for Leave to File, and this Certificate. This is fewer than the 14,000-word limit set by rules 8.520(b) and 8.204(c). In preparing this certificate, I relied on the word count generated by Word version 14, included in Microsoft Office Professional Plus 2010.

DATED: April 12, 2018

**COLANTUONO, HIGHSMITH &
WHATLEY, PC**



MICHAEL G. COLANTUONO
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Counties

PROOF OF SERVICE

*Michael McClain, Avi Feigenblatt, and
Gregory Fisher, v. Sav-On Drugs, et al.,
California Supreme Court Case No. S241471*

I, Ashley A. Lloyd, declare:

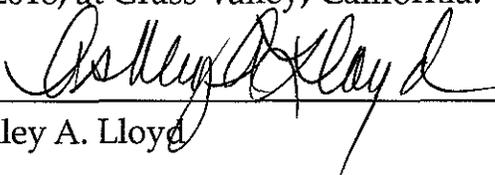
I am employed in the County of Nevada, State of California. I am over the age of 18 and not a party to the within action. My business address is 420 Sierra College Drive, Suite 140, Grass Valley, California 95945-5091. On April 12, 2018, I served the document(s) described as **APPLICATION TO FILE AMICUS CURIAE BRIEF AND BRIEF OF AMICI LEAGUE OF CALIFORNIA CITIES AND CALIFORNIA STATE ASSOCIATION OF COUNTIES** on the interested parties in this action addressed as follows:

SEE ATTACHED LIST

 K BY MAIL: By placing a true copy thereof enclosed in a sealed envelope. The envelope was mailed with postage thereon fully prepaid. I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid at Grass Valley, California, in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after service of deposit for mailing in affidavit.

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

Executed on April 12, 2018, at Grass Valley, California.



Ashley A. Lloyd

SERVICE LIST

*Michael McClain, Avi Feigenblatt, and
Gregory Fisher, v. Sav-On Drugs, et al.,
California Supreme Court Case No. S241471*

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