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## **Permitting Class Refund Actions Is Key to Effective Challenges of Illegal Taxes: California Court of Appeal Considers Ardon v. City of Los Angeles**

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### **Introduction & Summary**

When an illegal tax is being collected, taxpayers generally must first pay it, demand a refund, exhaust administrative appeals, and only then may file a lawsuit. Estuardo Ardon, who argues that the Telephone User's Tax (TUT) imposed by the City of Los Angeles is unconstitutional for failing to be approved by two-thirds of voters as required by California's Proposition 218, did so. (The question of the tax's constitutionality has not yet been considered by the court in this case.) His lawsuit was filed "on behalf of himself and all others similarly situated."

Such a class action lawsuit is useful in that it combines all who paid this tax into one comprehensive legal case, and if Ardon prevails, it ensures that the city must refund illegally collected taxes to all who paid them. While class actions are permitted for state tax claims in California, Los Angeles argues they are not allowed for local taxes. Instead, they contend, each individual taxpayer must submit his or her own refund claim for processing, administrative hearings, and litigation.

The California Court of Appeal should follow the precedent set by the California Supreme Court by holding that a class action for a tax refund is permissible under state law. In so doing, the Court will not only be promoting judicial efficiency but also saving time and money cost for claimants. Unless class actions are permitted in refund cases, the hurdles of

legal process may deter taxpayers from pursuing refund claims, permitting governments to keep the proceeds of illegally collected taxes and providing an incentive to levy them.

### **A State Law Authorizing Class Action Refunds Supersedes a Local Ordinance Barring Them**

California law says that a "claimant" seeking money or damages against a local public entity should follow the conditions set forth in state Government Code § 910 ("the Government Claims Act"), unless another statute has more specific procedures. A "claimant" is defined as a whole class of taxpayers, so each individual taxpayer need not submit his or her own refund demand. Once submitted, refund requests cannot be challenged by the government on technical errors so long as they are "substantially compliant."<sup>1</sup>

This case involves Los Angeles's municipal Telephone User's Tax (TUT) and the local ordinance authorizing that tax outlines refund procedures. In order to seek a refund if this tax is overpaid, a taxpayer must submit a claim in person; class claims are prohibited.<sup>2</sup>

If Los Angeles's municipal code were a "statute," it would supersede the default general procedures of state law. However, a "statute" is defined under California law as "an act adopted by the Legislature of this State or by the Congress of the United States, or a statewide initiative act."<sup>3</sup> The Los Angeles Municipal Code is consequently not a "statute" within this meaning.

Because the Los Angeles refund ordinance does not qualify as an exception to state law § 905(a), only the default rules of § 910 are applicable. Previous cases have reached a similar conclusion. In *Volkswagen Pacific, Inc. v. City of Los Angeles*, the California Court of Appeal held that tax refund claims procedures prescribed by a city ordinance and charter provision did not establish an exception under § 905(a) because the local enactments were not statutes.<sup>4</sup> In *County of Los Angeles v. Superior Court*, the taxpayer presented a class claim seeking damages for a purportedly illegal utility user's tax.<sup>5</sup> Though there was a local ordinance that provided a procedure for requesting a refund, the court ruled that the procedure was not part of a *statute* and thus only Government Claims Act claims presentations provisions applied.

Thus even where a city has passed an ordinance providing taxpayer refund procedures, the state Government Claims Act may still supersede them where no *statute* specifies narrower rules.

### **A Class Refund Claim Should Be Permitted So Long As It is Substantially Compliant with State Law**

Under the state Government Claims Act, class actions are sufficient if (1) there is "some compliance with all of the statutory requirements"; and (2) the claim discloses sufficient information to enable the public entity adequately to investigate the merits of the claim so as to settle the claim, if appropriate.<sup>6</sup>

This "substantial compliance test" evaluates claims to ensure they contain sufficient information to enable the governmental entity, either from its own records, or from the claim

itself, to reasonably determine the circumstances that have given rise to liability and the possible outer limits of that liability.<sup>7</sup> (Additionally, "claimant" under California state law refers to the class itself rather than to each individual class member.<sup>8</sup>) Courts have thus rejected requiring each individual member of the purported class to file a claim. In *San Jose*, the Court believed that requiring "such detailed information in advance of the complaint would severely restrict the maintenance of appropriate class actions-contrary to recognized policy favoring them."<sup>9</sup>

Such a procedure does not immediately harm revenue collection. A class claim must also provide the name, address, and other specified information concerning the representative plaintiff and must also provide sufficient information to identify and make ascertainable the class itself. Once the claim has been presented, the public entity has 45 days within which to act, unless the parties agree to extend the period.<sup>10</sup> The claim is deemed rejected if the public entity fails to act within the time provided, allowing the claimant to pursue judicial means of relief.<sup>11</sup> (Tax refunds generally must first exhaust administrative remedies before proceeding to court.) The public entity must provide written notice of its action on the claim or of the claim's rejection by operation of law.<sup>12</sup> These procedural requirements, as well as the judicial consideration inherent in class certification and granting injunctive relief, ensures that local revenue collection will not be irreparably damaged and obviates the need for a ban on class claims beyond the statute's limits.

In this case, Ardon's complaint provides sufficient notice about the extent of his claim and the parameters of the proposed class. The City can calculate its revenue collections from the challenged tax based on the information provided and therefore know the extent of its liability. Ardon has therefore met the burden imposed by the purpose and language of the statute.

### **The *Woosley* Strict Compliance Series of Cases is Inapplicable**

A separate line of cases requires strict compliance with local procedures in determining whether a class claim can be asserted.<sup>13</sup>

These cases are premised on the holding in *Woosley v. State*, where a taxpayer brought a class action suit to recover refunds for motor vehicle license fees and use taxes.<sup>14</sup> The Court in *Woosley* ruled that the class action could not be permitted because under the Vehicle Code, claims must be made by each person individually. Within the context of this statute, the term 'person' does not include a class, and a class representative who files a claim on behalf of all others similarly situated, without the knowledge or consent of such other persons, is not the agent of the members of the class.

The present case can be distinguished from the *Woosley* case and its progeny that have prohibited class suits for tax refunds. In these cases, courts are enforcing a *statute* (state law, not local ordinance) that governs the refund procedures for a particular law, not default § 910 procedures. The state Government Claims Act applies only if there is no other relevant statute; where another statute applies, a taxpayer need not meet any of the § 910 requirements.

The present case is not against the state but against a local government, and therefore the constitutional basis for *Woosley* is inapplicable. There is no *statute* governing the refunding of the telephone user's tax, so Ardon should be able to assert a class refund claim under the Government Claims Act even if every taxpayer agreed to the suit.

### **Permitting Class Refund Claims Furthers the Due Process and Taxpayer Protection Goals of the California Constitution**

California's Constitution reflects a number of important goals. On one hand it is paramount that local governments have a stable source of money, and injunctions that prevent revenue collection are consequently disfavored.<sup>15</sup>

On the other hand, taxpayer protection provisions and due process favor procedures that invalidate illegal taxes and efficiently disgorge improperly collected funds in the form of refunds.<sup>16</sup> Under Proposition 13 in 1978 and Proposition 218 in 1996, all tax and fee increases by local governments must be submitted to the voters for approval.<sup>17</sup> Proposition 218 further stated that it "shall be liberally construed to effectuate its purposes of limiting local government revenue and enhancing taxpayer consent."<sup>18</sup>

Local governments have an interest in protecting revenue collection, but only to the extent that the revenue collection is legal. If a tax or fee is illegally imposed, part of the judicial resolution must be the refund of the money so as to prevent unjust enrichment and an incentive to impose illegal taxes.

This case has a broader importance in deterring illegal taxes and refunding the money to taxpayers. By aggregating claims, class actions reduce legal and transaction costs for taxpayers seeking refunds and procedural costs for courts processing claims. A class action also ensures that one legal decision will govern all similar claims. Unless class actions are permitted in refund cases, the hurdles of legal process may deter taxpayers from pursuing refund claims, permitting governments to keep the proceeds of illegally collected taxes.

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### **Notes**

1. *See City of San Jose v. Superior Court*, (1974) 12 Cal. 3d 447.
2. *See* Los Angeles Municipal Code § 21.07(c).
3. Gov. Code § 811.8.
4. (1972) 7 Cal. 3d 48.
5. (2008) 159 Cal.App. 353, 356.

6. *See San Jose*, 12 Cal. 3d at 456.
7. *See id.*
8. *See id.* at 457.
9. *Id.* at 457.
10. *See* Gov. Code, § 912.4(a)-(b).
11. *Id.*, § 912.4(c).
12. *See* § 913.
13. *See, e.g., Farrar v. Franchise Tax Bd.*, (1993) 15 Cal. App. 4th 10; *Neecke v. City of Mill Valley*, (1995) 39 Cal. App. 4th 946; *Howard Jarvis Taxpayers Ass'n. v. City of Los Angeles*, (2000) 79 Cal. App. 4th 242.
14. (1992) 3 Cal. App. 4th 758.
15. *See, e.g., Pacific Gas & Electric*, 27 Cal. 3d at 283 ("The policy behind section 32 [of the Constitution] is to allow revenue collection to continue during litigation so that essential public services dependent on the funds are not unnecessarily interrupted."); *Dows v. City of Chicago*, 78 U.S. (11 Wall.) 108, 110 ("Any delay in the proceedings of the officers, upon whom the duty is devolved of collecting the taxes, may derange the operations of government, and thereby cause serious detriment to the public.").
16. *See, e.g.,* Cal. Const. art. XIII § 32 (authorizing refund actions to recover tax paid plus interest).
17. *See* Cal. Const. art. XIII C.
18. Text of Proposition 218 § 5.

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