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## Permitting Class Refund Actions Protects California Taxpayers Against Illegal Taxes: *Ardon v. City of Los Angeles*

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### Introduction

The Tax Foundation recently filed an *amicus curiae* (“friend of the court”) brief with the California Supreme Court in the case of *Ardon v. City of Los Angeles*, No. S174507. This case involves the right of California taxpayers to collectively file a refund for improperly collected local taxes.<sup>1</sup>

Estuardo Ardon is a California taxpayer who has successfully challenged the constitutionality of the telephone excise tax in Los Angeles. Ardon filed a tax refund claim “on behalf of himself and all others similarly situated,” asserting that state law (California Gov. Code Section 910) permits him to file such a “class action” lawsuit. Ardon argued that the California Supreme Court has previously permitted class filings in the case *City of San Jose v. Superior Court*.<sup>2</sup>

Los Angeles rejected this argument, claiming instead that each taxpayer must file a separate refund claim. The California Court of Appeal agreed with the City and barred Ardon’s class claim.<sup>3</sup> The Court did not rely on *San Jose* to decide the case, but instead looked to another case, *Woosley v. State of California*.<sup>4</sup> The Court also concluded that public policy “underlying” the California Constitution bars taxpayer claims for collective relief when local government revenue interests are at stake.<sup>5</sup> The California Supreme Court granted review in September 2009.

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<sup>1</sup> The California Supreme Court may hear oral arguments in the case in the fall of 2010. The Ardon case may be heard in conjunction with *Leoffler v. Target*, No. S173972, a case which contests a lower court ruling that a class of consumers cannot sue retailers for illegal collection of a sales tax under state consumer protection laws.

<sup>2</sup> 12 Cal.3d 447, 457 (1974).

<sup>3</sup> *Ardon v. City of Los Angeles*, (2009) 174 Cal. App. 4th 369, 370-71.

<sup>4</sup> 3 Cal. App. 4th 758, 792 (1992).

<sup>5</sup> *Ardon*, *supra* note 3, at 373. (“The policy underlying article XIII, section 32 is that strict legislative control over the manner in which tax refunds may be sought is necessary so that governmental entities may engage in fiscal planning.”).

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The California Constitution protects taxpayers against improper taxation by local government, particularly where state law has denied taxpayers the opportunity to pursue refunds through other means.<sup>6</sup> Public policy does protect local government revenues from unnecessary disruption, but not for the purpose of permitting governments to retain illegally collected revenue. Rather, the underlying operative policy is that taxpayer control and consent should be enhanced—even at the cost of reduced public services. This policy is most clearly reflected by California voters’ passage of Propositions 13 and 218, which created public policy and constitutional amendments to restrict local government taxes.<sup>7</sup>

The class claim mechanism is important for taxpayers and for the government, facilitating efficiency in claim processing and uniformity in claim resolution. It is particularly useful where claimants are many and the amount claimed by each taxpayer is small, as is the case with the Telephone Users Tax (“TUT”) challenged in *Ardon*. Without such a remedy, legal and transaction costs associated with individual refund claims will have the practical effect of permitting government retention of illegally collected revenues.

The Court of Appeal’s decision incorrectly prioritized local government revenue maintenance over taxpayers’ right to meaningful relief against illegal taxes, and it should be reversed.

## **Voters Have Amended the Constitution to Limit Local Government Revenue Collection and Favor Taxpayer Control**

California voters have repeatedly attempted to constrain local government taxing power. California voters have passed Propositions 13 and 218 to amend the Constitution, limiting “the methods by which local government exacts revenue from taxpayers without their consent.”<sup>8</sup> Proposition 13, passed in 1978, prohibits counties, cities, and special districts from enacting special taxes without voter consent.<sup>9</sup> When voters found that local governments still managed to impose excessive taxes that frustrated Proposition 13’s purpose, they passed Proposition 218.<sup>10</sup> That measure gives voters express power to contest and repeal local taxes and requires that government have the burden of proving that a contested tax is legal.<sup>11</sup> The California courts are obligated to interpret such amendments in a manner that “effectuates the voters’ purpose in adopting the law.”<sup>12</sup>

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<sup>6</sup> See California Public Utility Code Section 799, which denies taxpayers the opportunity to contest taxes imposed through telephone service providers.

<sup>7</sup> See Article XIII C and Article XIII D of the California Constitution.

<sup>8</sup> *Silicon Valley Taxpayers v. Santa Clara County Open Space*, 44 Cal. 4th 431, 448 (2008).

<sup>9</sup> See *Howard Jarvis Taxpayer Ass’n v. Riverside*, 73 Cal. App. 4th 679, 683 (1999).

<sup>10</sup> Ballot Pamp., Gen. Elec. (Nov. 5, 1996) text of Prop. 218, Section 2 states, “The people of the State of California hereby find and declare that Proposition 13 was intended to provide effective tax relief and to require voter approval of tax increases. However, local governments have subjected taxpayers to excessive tax, assessment, fee and charge increases that not only frustrate the purposes of voter approval for tax increases, but also threaten the economic security of all Californians and the California economy itself. This measure protects taxpayers by limiting the methods by which local governments exact revenue from taxpayers without their consent.”

<sup>11</sup> *Silicon Valley*, *supra* note 9, at 445 (“This measure shifts the burden of proof in these lawsuits to local government. As a result, it would be easier for taxpayers to win lawsuits, resulting in reduced or repealed fees and assessments...Or stated another way, Proposition 218 was intended to make it more difficult for an assessment to be validated in a court proceeding.”); see also Cal. Const. Art. XIII D § 6 (“In any legal action contesting the validity of a fee or charge, the burden shall be on the agency to demonstrate compliance with this article.”).

<sup>12</sup> *Id.*, at 448.

These changes limit the methods by which local government can impose illegal taxes, while enhancing taxpayers' ability to control local taxes.<sup>13</sup> In *Ardon v. City of Los Angeles*, the Court of Appeal did not consider these specific constitutional changes, relying instead on a policy analysis with no basis in the Constitution itself.

## California's Constitution Supports Taxpayers' Refund Remedies

Article 13 Section 32 of the California Constitution states that “[n]o 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.” In *Woosley*, the Court stated that Section 32 confers “strict legislative control over tax refunds...so that governmental entities can engage in fiscal planning.”<sup>14</sup> The Court of Appeal here found that a policy “underlying” Section 32 precludes Ardon’s claim because a potentially large collective refund might bring uncertainty to local government’s revenue needs.<sup>15</sup>

On its face, Section 32 prohibits injunctions against tax collection and requires that taxpayers pay contested taxes before taking legal action to stop tax collection.<sup>16</sup> Both the anti-injunction policy and the “pay before litigating” policy ensure that revenue planning is not interrupted while courts resolve taxpayer claims. Neither policy justifies immunization of a tax from any taxpayer challenge whatsoever. In fact, other cases specifically recognize taxpayers’ right to demand refunds once they have paid the contested tax.<sup>17</sup> In any event, local governments’ interest in fiscal planning does not permit illegal revenue retention, or overrides taxpayers’ right to seek meaningful refunds for illegal local taxes.<sup>18</sup>

Ardon has paid his tax and should be able to demand a refund without any Section 32 issue.

## Government Code Section 910 Permits Class Refund Claims

Section 910 generally authorizes refund claims, although it is unclear on its face whether class claims are permitted. The Court of Appeal argued that the existence of narrower tax laws that provide class claim exceptions or modifications to Section 910 means that Section 910 only permits individual claims.<sup>19</sup> The Court observed that some of these narrow laws explicitly used the word “class” to give a class remedy and that Section 910 did not use the word “class.”<sup>20</sup> On this basis, the Court of Appeal concluded that Section 910 only permitted individual claims.

This reading of Section 910 as inherently prohibiting class claims runs counter to the California Supreme Court’s analysis in *San Jose*. The *San Jose* Court observed that the word “claimant” in Section 910 “must be equated with [a] class itself,” because otherwise, the purpose of the law would be

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<sup>13</sup> *Silicon Valley*, *supra* note 9, at 448.

<sup>14</sup> *Woosley*, 3 Cal. App. 4th 758, 789 (1992).

<sup>15</sup> *Ardon*, 174 Cal. App. 4th 369, 370-71 (2009).

<sup>16</sup> *See Pacific Gas & Electric v. State Board of Equalization*, 27 Cal.3d 277, 283(1980) (“The policy behind section 32 is to allow revenue collection to continue during litigation so that essential public services dependent on the funds are not unnecessarily interrupted.”).

<sup>17</sup> *See, e.g., Macy Dep’t Stores, Inc. v. City and County of San Francisco*, 143 Cal. App. 4th 1444, 1453 (2006) (“Article XIII, section 32 recognizes the taxpayer’s right to refund of an illegal tax, as a corollary to the prohibition against enjoining the collection of any tax.”).

<sup>18</sup> *See Ardon*, *supra*, note 15, at 384.

<sup>19</sup> *See Ardon*, *supra*, note 15, at 254.

<sup>20</sup> *Id.*

undermined and lead to perverse and unduly burdensome effects on taxpayers.<sup>21</sup> Therefore, narrower tax laws using the word “class” do not restrict the breadth of the general law that governs other claims.

## **Class Claims Discourage Illegal Tax Retention and Provide Meaningful Process to Taxpayers**

The California Constitution favors procedures that are meaningful for taxpayers, reducing legal hurdles and transaction costs so that taxpayers can efficiently retrieve improperly collected funds.<sup>22</sup> Due process generally requires that where lawmakers have barred taxpayers from pursuing one remedy for a refund, an alternative remedy must be made available.

In Ardon’s case, a class claim is the only meaningful way to exercise a constitutionally guaranteed right to seek refunds. In 1996, California eliminated taxpayers’ ability to file any claim, including class claims, against telephone service providers.<sup>23</sup> This law allowed the City of Los Angeles to continue to collect the tax while depriving taxpayers of the meaningful opportunity to challenge it through their service providers. The lack of a meaningful remedy underscores the importance of the class claim as a deterrent to the government’s ongoing collection and retention of an illegal tax.

## **Class Claims Provide Efficiency to Administrative and Judicial Claim Resolution**

Class claims provide administrative efficiency by (1) providing the public entity with a thorough amount of information through one claim so that it can more readily investigate the merits of the claim, (2) facilitating settlement of a meritorious refund claim by uniformly deciding to accept or deny multiple refunds through one claim, (3) providing the public entity with immediate notice that the tax is being challenged by a large group of persons, and (4) limiting the government’s liability by ensuring that its final decisions preclude further individual claims on the same issue.<sup>24</sup>

Class petitions have similar cost-reducing impacts on judicial proceedings, especially as in this case, where the amount claimed by each member of the class is very low. Where the government does owe a refund, the court may require the government to pay back illegally collected taxes even if only one individual filed the claim. And if the government does not owe a refund, the court’s singular resolution of multiple claims is to the government’s advantage.

## **Conclusion**

Class actions are the only meaningful way to refund illegal taxes paid by millions of Los Angeles residents. The Supreme Court’s decision in *Ardon* will have special significance for California taxpayers’ ongoing efforts to deter illegal tax collection and over-taxation by local government. As the Court concluded in *San Jose*, class actions should be permitted under Section 910. Such a result would make the tax law consistent with constitutional taxpayer protections and deter governments from retaining illegal tax proceeds.

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<sup>21</sup> *City of San Jose, supra*, note 2, at 457.

<sup>22</sup> *See, e.g.*, Cal. Const. art. XIII, § 32 (authorizing refund actions to recover tax paid plus interest).

<sup>23</sup> Cal. Pub. Util. Code § 799.

<sup>24</sup> *Westcon Const. Corp. v. County of Sacramento*, 61 Cal. Rptr. 3d 89, 101 (Cal. Ct. App 2007).