No. _____

In The
Supreme Court of the United States

MICHAEL McCLAIN, AVI FEIGENBLATT AND GREGORY FISHER,

Petitioners,

v.

CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION; SAV-ON DRUGS, ET AL.,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of California

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Does a State violate the Due Process Clause and trigger a right to just compensation under the Takings Clause when it permanently escheats private property from an intermediary to itself under a statutory scheme that denies standing to the real parties in interest, including denying them any right to a judicial or administrative procedure by which to reclaim their private property?

LIST OF ALL PARTIES

Plaintiffs-appellants, who are petitioners before this Court, are three California individuals who are insulin-dependent diabetics: Michael McClain, Avi Feigenblatt and Gregory Fisher.

The governmental defendant-respondent below is the California Department of Tax and Fee Administration which, in 2017, succeeded to the tax-related duties, powers, and responsibilities of the California State Board of Equalization. This Petition will refer to those two departments as "the State Board." The State of California and its above mentioned two departments are referred to collectively as "the State."

The non-governmental defendants-respondents are certain chain pharmacies doing business in California. The California Supreme Court's ruling in favor of the Respondent pharmacies—unlike its ruling in favor of the State—does not implicate an important question of federal law. Accordingly, Petitioners have recently settled with the Respondent pharmacies in exchange for a waiver of costs incurred to date. The Respondent pharmacies are therefore only nominal parties in the proceedings before this Court.*

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* The identities of the Respondent pharmacies are SAV-ON DRUGS, a Delaware corporation; LONGS DRUG STORES CORPORATION, a Maryland corporation; LONGS DRUG STORES CALIFORNIA, INC., a California corporation; RITE AID CORPORATION, a Delaware corporation; WALGREEN CO., an Illinois corporation; TARGET CORPORATION, a Minnesota corporation; ALBERTSON'S, INC., a Delaware corporation; THE VONS COMPANIES, INC., a Michigan corporation, doing business as VONS and as PAVILLIONS; VONS FOOD SERVICES, INC., a California corporation; and WAL-MART STORES, INC., a Delaware corporation.

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These two lawsuits[1] were brought on behalf of millions of California diabetics who use blood glucose test strips and skin puncture lancets to monitor their blood sugar levels to determine when they need to use insulin. While California law exempts these medically essential products from taxation, Respondent retailers have nonetheless collected sales tax reimbursement from diabetic customers on sales of test strips and lancets for over a decade and remitted the overcharged amounts, known as "excess sales tax reimbursement," to the State pursuant an escheat statute embedded in the sales tax law as Tax Code §6901.5. The State, however, never returns the escheated excess sales tax reimbursement to the consumers who paid the overcharges and are the rightful owners; not to the diabetics in this case and not to the consumers in any other case where excess sales tax reimbursement has escheated to the State.

The problem is not that the State Board rules against consumer claims; that would be redressable by judicial review. Rather, the State Board *never* rules at the behest of consumers, who are the real parties in interest and from whom the money was actually taken. Nor, as held by the California Supreme Court in the instant case, can the State Board be compelled by consumers to rule. And while the State Board recognizes

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[1] Separate lawsuits were brought for test strips and lancets, resulting in separate appeals. Briefing was consolidated in the courts below as well as here.

retailers as having standing, retailers have no incentive to file sales tax refund claims (and are actually hostile to such claims) because they are required by California law to return any proceeds to their customers. The result is a statutory scheme that provides the real parties in interest—consumers—with no rights to notice or judicial or administrative procedures by which to compel return of their personal property, while unjustly enriching the State by millions of dollars each year through systematic Takings without just compensation.

Last term this Court decided *Timbs v. Indiana*, 139 S.Ct. 682 (2019) ("*Timbs*"), a case involving excessive civil asset forfeitures by States. Justice Ginsburg, writing for a unanimous court, quoted Justice Scalia's observation in *Harmelin v. Michigan*, 501 U.S. 957, 979, n. 9 (1991), that "it makes sense to scrutinize governmental action more closely when the State stands to benefit." Justice Ginsburg then echoed Justice Scalia's concerns, this time with respect to "fines and fees," which are also exactions that financially benefit States at the expense of their citizenry:

> This concern is scarcely hypothetical. *See* Brief for American Civil Liberties Union et al. as *Amici Curiae* 7 ("Perhaps because they are politically easier to impose than generally applicable taxes, *state and local governments nationwide increasingly depend heavily on fines and fees as a source of general revenue*.").

Timbs, 139 S.Ct. at 689 (emphasis added).

In 2016, Justices Alito and Thomas had expressed similar concerns about another increasing source of State's revenue collection, the escheat of private property:

> As advances in technology make it easier and easier to identify and locate property owners, many States appear to be doing less and less to meet their constitutional obligation to provide adequate notice before escheating private property. Cash-strapped States undoubtedly have a real interest in taking advantage of truly abandoned property to shore up state budgets. But they also have an obligation to return property when its owner can be located. To do that, States must employ notification procedures designed to provide the pre-escheat notice the Constitution requires.

Taylor v. Yee, 136 S.Ct. 929, 930 (2016).

Justices Alito and Thomas suggested that "the constitutionality of current state escheat laws is a question that may merit review in a future case" but concluded that "[t]he convoluted history of [*Taylor v. Yee*] makes it a poor vehicle for reviewing the important question it presents." The Justices therefore concurred in the denial of the Petition for Writ of Certiorari in *Taylor v. Yee*.

The instant California Supreme Court decision is very likely that "future case" on the constitutionality of State escheats of private property that Justices Alito and Thomas were seeking. In approving a permanent State escheat of private property without providing the

rightful owners with any notice or judicial or administrative procedure by which to compel its return, the California Supreme Court has decided important federal questions in a way that conflicts with Due Process decisions of this Court. And by denying Petitioners leave to amend their operative complaint to add a constitutional Takings Clause claim, the California Supreme Court has decided important federal questions in a way that conflicts with Takings Clause decisions of this Court.

Moreover, the instant case—unlike the "convoluted history" of *Taylor v. Yee*—presents a clean "vehicle for reviewing the important question" of "the constitutionality of current state escheat laws" both under the Due Process Clause and the Takings Clause. Accordingly, Petitioners respectfully petition this Court for a writ of certiorari to review the judgment of the Supreme Court of California.

OPINIONS BELOW

The California Supreme Court's opinion is reported at 6 Cal.5th 951 (2019) and reproduced at App.1-20. The Second District Court of Appeal's order modifying its opinion and denying rehearing is available at 2017 Cal. App. LEXIS 3271 and reproduced at App.21-22. The Court of Appeal's opinion is reported at 9 Cal.App.5th 684 (2017) and reproduced at App.23-55. The trial court announced its decision sustaining Respondents' demurrers from the bench on February 24,

2015. The relevant pages of the transcript are reproduced at App.56-66.

JURISDICTION

The California Supreme Court issued its opinion on March 4, 2019. This Court has jurisdiction under 28 U.S.C. §1257(a).

CONSTITUTIONAL PROVISIONS AND STATUTES AT ISSUE

The relevant Constitutional provisions and statutes are reproduced at App.67-70.

STATEMENT OF THE CASE

A. Preview of the Statutory Scheme

One of the cardinal principles of civil law is that actions must be prosecuted in the name of the real party in interest. *See* Fed.R.Civ.P. 17 ("An action must be prosecuted in the name of the real party in interest."). Whenever a State's statutory scheme deviates from the real-party-in-interest rule, the State is asking for trouble. If the State is also the financial beneficiary from disenfranchising the real parties in interest, constitutional violations under the Takings Clause and Due Process Clause are inevitable.

California nevertheless chose to run the risk of unconstitutionality when it designed the structure of its Retail Sales Tax Act of 1933 ("the 1933 Act") to achieve an arguably illegitimate purpose: the taxation of sales to tax-exempt entities such as national banks and other instrumentalities of the federal government. To achieve that result, California had to levy the sales tax on retailers, rather than on consumers as is customary, so that sales to tax-exempt consumers could be taxed *to the non-exempt retailer.* However, it was always intended that the economic incidence of the sales tax would fall on consumers through payment of "sales tax reimbursement" to the retailer at the point of sale.

A byproduct of levying the sales tax on retailers is that they are considered to be the "taxpayers" authorized to file tax refund claims under Tax Code §6902(a) even though they are fully reimbursed by their customers, who are the real parties in interest. Thus, the cornerstone of the Act was violation of the real-party-in-interest rule. This case concerns the Takings Clause and Due Process Clause violations that have inevitably resulted from that decision.

The judgment in this case enshrines into case law California's on-going practice of permanently taking for the State's coffers millions of dollars of excess sales tax reimbursement, which is a form of statutorily recognized private property that is generated when consumers are overcharged "sales tax" by retailers on tax-exempt purchases. Although such *excess* sales tax reimbursement is *not* owed to the State as taxes, but

rather belongs to the consumers who were overcharged, the fully reimbursed retailers are nevertheless compelled by California Tax Code §6901.5 to remit all such sums to the State to prevent the retailers from becoming unjustly enriched. Avoidance of unjust enrichment is a traditional justification for escheat of private property by the government, but unlike constitutionally valid escheats, here California exercises complete and permanent dominion over the remitted sums without ever providing the rightful owners—consumers—any notice or judicial or administrative procedure by which to obtain a return of their property.

B. Proceedings in the Trial Court

First filed in December 2004, these cases were originally brought solely against retailers. The cases were stayed for six years while another sales tax case against retailers was pending before the California appellate courts. Shortly after that case was decided in *Loeffler v. Target Corp.*, 58 Cal.4th 1081 (2014) ("*Loeffler*"), the stay in this case was lifted and Petitioners were granted leave to amend in light of *Loeffler*.

Petitioners' new Fifth Cause of Action was the only cause of action against the State of California. It was based upon the California Supreme Court's decision in *Javor v. Board of Equalization*, 12 Cal.3d 790, 802-03 (1974) ("*Javor*"), which held as follows:

> [U]nder the unique circumstances of this case a customer, who has erroneously paid an excessive sales tax reimbursement to his

> retailer who has in turn paid this money to the Board, may join the Board as a party to his suit for recovery against the retailer in order to require the Board in response to the refund application from the retailers to pay the refund owed the retailers into court. . . . [A]llowing the Board to be joined as a party for these purposes in the customer's action against the retailer is an appropriate remedy entirely consonant with the statutory procedures providing for a customer's recovery of erroneously overpaid sales tax.

Respondents demurred to Petitioners' Fifth Cause of Action. Petitioners' trial court brief in opposition argued that their complaint alleged a valid claim for a State-law *Javor*-type remedy. Petitioners also argued that rejection of the *Javor*-type remedy would "render the entire sales tax reimbursement scheme unconstitutional" because:

> To deny consumers a remedy to recover sales tax reimbursement they have wrongfully been charged on tax exempt purchases would (1) constitute a public "taking" of private property without just compensation, and (2) a deprivation of property without due process of law, both of which are violations of the Fifth Amendment to the U.S. Constitution, as made applicable to the States through the Fourteenth Amendment. (*Webb's Fabulous Pharmacies v. Beckwith* (1980) 449 U.S. 155, 160 and 164 ["a State, by *ipse dixit*, may not transform private property into public property without compensation"].) Reclassifying private property

> as public property is exactly what California will do if Plaintiffs here are denied a remedy.

Petitioners' brief further argued that Tax Code §6901.5 works an "escheat" that would become a *per se* taking if Petitioners' *Javor*-type claim were rejected:

> The fact that California had the taxing power (but did not use it) to make all sales of glucose test strips and lancets taxable does not save it from committing an unconstitutional escheat. (*Koontz v. St. Johns River Water Mgmt. Dist.* (2013) 133 S.Ct. 2586, 2600-2601 ["we have repeatedly found takings where the government, by confiscating financial obligations, achieved a result that could have been obtained by imposing a tax"].)
>
> . . .
>
> Indeed, under [Respondents'] view of current law, the escheat requirement of §6901.5 operates as a "physical taking" by the State rather than a "regulatory taking," causing §6901.5 to work a *per se* taking for which consumers are entitled to just compensation without "complex factual assessments of the purposes and economic effects of government actions." (*Brown v. Legal Foundation* (2003) 538 U.S. 216, 233-234.) Moreover, by making consumers' consent irrelevant and depriving consumers of a right to enforce their contract, Defendants' and the SBE's view of current law constitutes an unconstitutional deprivation of property without due process of law.

However, a Takings Clause claim could not be brought as long as Petitioners' *Javor* claim was still viable. *See Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 192-94 (1985) ("*Williamson*"). Petitioners' brief in opposition to demurrer therefore requested leave to amend "if the Court sustains in any part Defendants' demurrer."

The trial court ultimately sustained the demurrers without leave to amend. Petitioners were thereby barred from proving their allegation that all pharmacy sales of glucose test strips and skin puncture lancets are tax exempt under California law. For purpose of this proceeding, however, Petitioners' allegation must be accepted as true (1) under the rules governing dismissals on demurrer,[2] (2) under this Court's decision in *First English Evangelical Lutheran Church v. City of L.A.*, 482 U.S. 304 (1987) ("*First English*") reserving substantive issues for remand,[3] and (3) because the

[2] *Schifando v. City of Los Angeles*, 31 Cal.4th 1074, 1081 (2003) ("When reviewing a judgment dismissing a complaint after the granting of a demurrer without leave to amend, courts must assume the truth of the complaint's properly pleaded or implied factual allegations. . . . Courts must also consider judicially noticed matters.").

[3] This Court held in *First English*, 482 U.S. at 312-13, as follows:

> We reject appellee's suggestion that, regardless of the state court's treatment of the question, we must independently evaluate the adequacy of the complaint and resolve the takings claim on the merits before we can reach the remedial question. . . . We accordingly have no occasion to decide whether the ordinance at issue actually denied appellant all use of its property or whether the county might avoid the conclusion that a

State Board does not, as a factual matter, even disagree with Petitioners' allegation. (*See infra* pp.23-24.)

After the trial court announced its decision to sustain Respondents' demurrers, Petitioners' counsel requested leave to amend to add a constitutional Takings Clause claim:

> Mr. MacLeod: Then the only point really that I had to make that wouldn't be repetition, your Honor, is that there is a constitutional claim that has not been ripe in this case up until this point.
>
> As long as Javor was still in play, the class has an inchoate claim for just compensation under the takings clause of the U.S. Constitution and also a claim for violation of due process.
>
> As long as Javor, which was designed to avoid the constitutional issues, was still in play, we did not feel we would [sic: could] bring that claim, but if it is to be the Court's decision that the Javor claim is dismissed, then we would like leave to amend to add the constitutional claims.
>
> THE COURT: I understand that argument. You made that clear on the record. App.60.

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compensable taking had occurred. . . . These questions, of course, remain open for decision on the remand we direct today.

The court then ruled on Petitioners' request for leave to amend as follows:

> I am not going to give leave to amend. Respectfully I disagree with counsel as to whether the proposed amendments that have been identified clearly on this record would do anything at all to salvage these claims. App.63.

In every brief and hearing thereafter, Petitioners argued that absent the *Javor* remedy, the State's escheat of excess sales tax reimbursement would be a violation of Due Process and a Taking for which just compensation would be owed under the Constitution. The Court of Appeal, however, expressly refused to consider Petitioners' escheat argument. App.22.[4]

The escheat argument was also a focus of Petitioners' briefs in the California Supreme Court. However, that court's opinion likewise fails to address Petitioners' escheat argument. Thus, among all of the opinions in the California courts, the word "escheat" is mentioned only once, and that was when the Court of

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[4] The Court of Appeal's refusal was based on the mistaken ground that the escheat argument "appear[ed] nowhere in [Petitioners'] prior briefs . . . " when in fact the escheat argument was a focus of Petitioners' Due Process and Takings Clause briefs in the trial court and Court of Appeal. *See supra* pp.8-9 for quotes from Petitioners' trial court brief in opposition to demurrer. Petitioners' escheat arguments to the Court of Appeal appear in the appellate record at Appellants' Opening Brief 73-76; Appellants' Reply Brief 35-39; Appellants' Petition for Rehearing 20-21; 24; 26-36; 40-43.

Appeal expressly refused to consider Petitioners' escheat argument.

The California Supreme Court ultimately ruled against Petitioners by requiring consumers relying on *Javor* to "show, as a threshold requirement, that a prior legal determination has established their entitlement to a refund." App.9. However, that court itself admits that consumers have absolutely no ability to initiate or compel such a legal determination. *See Loeffler* at 1120 ("Section 6901.5 provides no procedure by which consumers can require the Board to 'ascertain' whether excess reimbursement has in fact been charged, nor is there a statutory procedure by which the consumer can make certain that the retailer will be ordered to refund an excess amount to the consumer."). And such cases are a null set because retailers never file tax refund claims, and without a tax refund claim, the State Board never makes a taxability determination. (*See infra* Sections I and J.)

Thus, Petitioners have raised their Due Process and Takings Clause arguments in every pertinent brief and hearing in the California courts below. Those courts, however, gave scant attention to the constitutional issues raised by Petitioners, with the Court of Appeal even expressly refusing to consider Petitioners' argument that Tax Code §6901.5 works an unconstitutional escheat.

C. The Incidence of the California Sales Tax

When the California Legislature enacted the 1933 Act it could have imposed the sales tax's legal incidence on retail buyers (a.k.a. "consumers," "customers," or "purchasers") and tasked retailers with the responsibility of collecting the tax and remitting the proceeds to the State Board.[5] The collection and payment of sales tax would have been much the same as it is now. However, purchasers would be "taxpayers" with standing to file and prosecute tax refund claims.

Instead, the Legislature decided to levy the tax on retailers "for the privilege of selling tangible personal property at retail." (1933 Act, §3, currently Tax Code §6051.) The reason was to capture sales tax on sales to tax-exempt consumers such as the federal government and national banks.[6] By levying the sales tax on

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[5] *See National Ice & Cold Storage Co. v. Pacific Fruit Express Co.*, 11 Cal.2d 283, 290 (1938) ("[I]t is commonly conceded . . . that, as affecting a transaction of the character of a sale of 'tangible personal property' it would have been within the power of the legislature to have imposed a tax upon either the retailer or the purchaser of such property.").

[6] State Board Legislative Bill Analysis for Senate Bill 472. May 24, 1977 [RJN Exh. F]: "One of the primary reasons for drafting the sales tax law as a tax on the retailer rather than the consumer was to provide for uniform application of tax to sales to all consumers, including those consumers who would be exempt were the tax imposed directly on the consumer. These consumers include certain agencies of the federal government and national banks, exempt under federal law, and state banks and insurance companies exempt under state law. Sales to unincorporated agencies of the federal government and corporations wholly owned by the federal government are specifically exempt from sales tax under the sales tax law."

retailers instead, sales to tax-exempt consumers could still be taxed *to the non-exempt retailer* (who would then pass the charge back to the tax-exempt consumer, either by bundling the tax into the price or by collecting sales tax reimbursement at the point-of-sale, both of which would effectively nullify the consumer's tax exemption).

D. Sales Tax Reimbursement

Notwithstanding California putting the sales tax incidence on retailers, it was always intended that the tax would be collected from consumers. Thus, the 1933 Act provided in Section 8½ that "The tax hereby imposed shall be collected by the retailer from the consumer insofar as the same can be done." As a result, whenever a California retailer charges "sales tax" at the point-of-sale, the consumer is not actually paying a tax. Rather, the consumer is paying the retailer "sales tax reimbursement."

E. *Diamond* and Civil Code §1656.1

The 1933 Act arguably infringed upon the sovereign immunity of the United States by effectively nullifying the sales tax-exemption for federal instrumentalities, such as national banks. In *Diamond Nat'l Corp. v. State Bd. of Equalization*, 425 U.S. 268 (1976) ("*Diamond*") this Court, in a brief *per curiam* opinion, held that:

> We are not bound by the California court's contrary conclusion and hold that the incidence of the state and local sales taxes falls

> upon the national bank as purchaser and not upon the vendors. The national bank is therefore exempt from the taxes under former 12 U.S.C. §548 (1964 ed.) which was in effect at the time here pertinent.

This Court decided *Diamond* on authority of *First Agricultural Nat. Bank v. Tax Comm'n*, 392 U.S. 339, 346-48 (1968). In that case this Court rebuked Massachusetts for having created "a sales tax which by its terms must be passed on to the purchaser."

Diamond was not binding upon California except in cases where the consumer was a tax-exempt instrumentality of the United States. California has therefore never conformed its Tax Code to *Diamond's* holding that consumers are the true taxpayers. *See Hibernia Bank v. State Bd. of Equalization*, 166 Cal.App.3d 393, 400 (1st Dist. 1985) ("California cases decided after *Diamond National* have consistently held that for state purposes, the legal incidence of the California sales tax continues to be on the retailer.").

The Legislature and State Board responded to *Diamond* in 1978 by attempting to eliminate any implication that California's sales tax law shared the same defect as the Massachusetts law at issue in *First Agricultural*: *i.e.*, that it not create a "sales tax which by its terms must be passed on to the purchaser." One of the primary changes to California law was the enactment of Civil Code §1656.1.

Civil Code §1656.1 became the only statutory authority for retailers to collect sales tax reimbursement from customers. It begins by stating:

> Whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale.

However, §1656.1 then creates a presumption in favor of the existence of an agreement by the customer to pay sales tax reimbursement "if . . . sales tax reimbursement is shown on the sales check or other proof of sale." Sub.(a)(3). But in the final adjustment, the last subsection states: "The presumptions created by this section are rebuttable presumptions." Sub.(d).

Civil Code §1656.1 removed the State Board from any role in determining whether a retailer may add sales tax reimbursement to the sales price by making it "a matter for a contractual agreement between seller and buyer." *Loeffler* at 1116-17. "The Board explained that with the repeal, it would 'have no statutory duty to police the retail trade to ensure that only the correct amount of tax reimbursement is collected from the customers on retail sales.'" *Id.* In order to further disentangle the State Board from sales tax reimbursement, the Legislature put the critical new statute in the Civil Code rather than the Tax Code.

F. Excess Sales Tax Reimbursement

California's statutory scheme works smoothly as long as the amount that a retailer charges to consumers at the point-of-sale equals the amount of the retailer's sales tax obligation to the State on the same transaction. Indeed, few consumers realize that they are paying retailers sales tax reimbursement at the point-of-sale rather than paying the State sales tax.

However, the statutory scheme breaks down if a retailer overcharges sales tax reimbursement, such as by collecting sales tax reimbursement on transactions that are legally tax exempt (as in this case). When a retailer collects more sales tax reimbursement from the consumer than the retailer owes as tax on the sale, the difference is referred to as "*excess* sales tax reimbursement." If the sale is legally tax exempt, any and all amounts collected are "excess sales tax reimbursement." Cal. Code Regs., tit. 18, §1700, subd. (b)(1) ("Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax.").

"*Excess* sales tax reimbursement" is statutorily defined by Tax Code §6901.5 as:

> an amount represented by a [retailer][7] to a customer as constituting reimbursement for taxes due under this part [that] is computed

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[7] Tax Code §6901.5 consistently refers to the retail seller by the ambiguous term "person" rather "retailer." Therefore, for the sake of clarity, quotations from §6901.5 in this brief substitute "[retailer]" for "person."

> upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the [retailer].

Since retailers are not the owners of such overcharges, they are required by Tax Code §6901.5 to remit such overcharges to the State in order to keep from being unjustly enriched.

G. Sales Tax Reimbursement and Excess Sales Tax Reimbursement Are Private Property, Not a Tax

Under the Takings Clause "[t]he existence of a property interest is determined by reference to 'existing rules or understandings that stem from an independent source *such as state law*.'" *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 164 (1998) ("*Phillips*") (emphasis added). Here, State law is clear. Under Cal. Civil Code §1656.1, sales tax reimbursement "depends solely upon the terms of the agreement of sale" between a buyer and a seller of tangible personal property. That is a description of private property, not a "tax." Indeed, California's sales tax structure *requires* that sales tax reimbursement *not* be a "tax" because if it were a tax, then (i) consumers would be the "taxpayers" and (ii) California would not be able to tax sales to tax-exempt entities.

Excess sales tax reimbursement is even more clearly private property than regular sales tax reimbursement because the consumers that own it (*see* Section H) are distinct from the "taxpayer" (*i.e.*, the

retailer). Moreover, it is definitionally impossible to characterize excess sales tax reimbursement as a "tax" because under Tax Code §6901.5 it is "computed upon an amount that is not taxable or is in excess of the taxable amount."

Indeed, if sales tax reimbursement were viewed as a tax, the decision below should be automatically reversed under this Court's decision in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36, 39 (1990) ("*McKesson*"):

> Because exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause. . . . To satisfy the requirements of the Due Process Clause, therefore, in this refund action the State must provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a "clear and certain remedy," *O'Connor*, 223 U.S., at 285, for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one.

Here, Petitioners were denied both (i) an "opportunity to challenge the . . . legal validity" of the State's confiscation of excess sales tax reimbursement and (ii) a "clear and certain remedy." Therefore, if sales tax reimbursement were viewed as a tax, the California Supreme Court's decision in this case would unquestionably conflict with *McKesson* and require reversal.

H. Excess Sales Tax Rightfully Belongs to Consumers

"Excess sales tax reimbursement" rightfully belongs to the consumers from whom it was collected. That fact was established by the California Supreme Court 57 years ago in *Decorative Carpets, Inc. v. State Board of Equalization*, 58 Cal.2d 252 (1962). In that case the plaintiff retailer had mistakenly paid sales taxes when it should have paid the use tax under the State Board's regulations. *Id.* at 253-54. The retailer claimed a tax refund from the State but "stipulated . . . that it is seeking the refund for itself only and does not intend to pass it on to [its] customers." *Id.* at 254. Those customers were the real parties in interest because the retailer had collected sales tax reimbursement from them at the point-of-sale, but "[t]he trial court held that Decorative Carpets was entitled to the refund on the ground that the retailer is the taxpayer" *Id.* Judgment was entered for the retailer and the State appealed, arguing that the plaintiff retailer would be unjustly enriched. The California Supreme Court reversed the trial court:

> The judgment is reversed and the cause remanded to the trial court with directions to enter judgment for plaintiff only if it submits proof satisfactory to the court that the refund will be returned to plaintiff's customers from whom the excess payments were erroneously collected. *Id.* at 256.

More recently, the California Supreme Court confirmed that consumers are the rightful owners of

excess sales tax reimbursement. *See Loeffler* at 1115 quoting *Javor* at 802 ("We observed that the Board 'is very likely to become enriched at the expense of the customer *to whom the amount of the excessive tax actually belongs*.'" (emphasis added)).

I. Retailers Have No Incentive to Claim a Refund of Excess Sales Tax Reimbursement

While the judgment in *Decorative Carpets* favored the customers, it had a perverse impact on future consumer claims for excess sales tax reimbursement. The message that retailers took away from *Decorative Carpets* was that, since they were going to be required to turn back to their customers any refund of excess sales tax reimbursement, it made no economic sense for them to file such a tax refund claim in the first place. Thus, as the California Supreme Court has twice acknowledged, "[b]ecause the retailer cannot retain the excess tax amount for itself, but must undertake some procedure to make refunds to customers, it may have no particular interest in pursuing a tax refund." *Loeffler* at 1115; *Javor* at 802.

Not only do retailers have no incentive to seek a refund of excess sales tax reimbursement, but they sometimes actively oppose consumer claims. Respondent retailers, for example, defended this case for 13 years—even to the point of opposing Petitioners' Fifth Cause of Action for a *Javor*-type remedy, as to which they were mere nominal parties—when all they had to

do to escape liability was file a tax refund claim and permit consumers to litigate the claims in their names.

J. The State Board Never "Ascertains" the Taxability Questions of Whether Excess Sales Tax Reimbursement Has Been Collected and Remitted to the State

The first step in the statutory process for refunding excess sales tax reimbursement to a retailer is for the State Board to "ascertain" that excess sales tax reimbursement has been remitted to the State. (Tax Code §6901.5.) Without retailers filing a refund claim, however, the State Board never "ascertains" whether excess sales tax reimbursement has been paid. This case is the perfect example. The State Board was first brought into this case in February 2006 on cross-complaints filed by the retailers. Ten years later, the State Board judicially admitted to the Court of Appeal in this case the following:

> Appellants interpret Regulation 1591.1 to mean that all sales of glucose test strips or skin puncture lancets are exempt from sales tax.
>
> However, there has been no binding determination by the Board that Appellants' interpretation is correct. . . . Because the taxability issue in this case has not been decided by the Board, the Superior Court properly dismissed the lawsuit.

Respondent's Brief of the California State Board of Equalization, 7/13/2016, pp.34-35.

The failure of the State Board to "ascertain" whether excess sales tax reimbursement has been paid in this case is not unique. Rather, it is the State Board's strategy to *never* rule at the behest of consumers. The State Board never ruled in the *Loeffler* case during its eight-year life in the courts. In *Littlejohn v. Costco Wholesale Corp.*, 25 Cal.App.5th 251 (2018), the State Board never ruled notwithstanding that a published "opinion of the Board's tax counsel" (known as an "Annotation"), a "letter from one of the Board's auditors," and the "Board's September 2013 Tax Information Bulletin" all favored the consumers' claim that the product Ensure is nontaxable. (*Id.* at 260.)

By never deciding at the behest of the real parties in interest whether excess sales tax reimbursement has been paid, the State Board avoids judicial review in a Superior Court action under Tax Code §6933.

K. Tax Code §6901.5 Results in a Facial Denial of Due Process and a Taking

Tax Code §6901.5 was enacted in 1982. A previous statute having similar terms was enacted as Tax Code §6054.5 in 1961 but was repealed in 1978 by Stats. 1978 ch. 1211, which was the same statute that adopted Civil Code §1656.1. Section 6901.5 can best be understood by separately considering the three subjects that it covers.

Subject 1: Description of Excess Sales Tax Reimbursement

Without using the term, §6901.5 correctly describes "excess sales tax reimbursement" as:

> an amount represented by a [retailer] to a customer as constituting reimbursement for taxes due under this part [that] is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the [retailer].

Subject 2: Disposition of Excess Sales Tax Reimbursement

The next phrase of §6901.5 covers the disposition of the excess sales tax reimbursement funds once they are "actually paid by the customer to the [retailer]":

> the amount so paid shall be returned by the [retailer] to the customer upon notification by the Board of Equalization or by the customer that such excess has been ascertained. In the event of his or her failure or refusal to do so, the amount so paid, if knowingly or mistakenly computed by the [retailer] upon an amount that is not taxable or is in excess of the taxable amount, shall be remitted by that [retailer] to this state.

According to the above passage, the trigger for the retailer's obligation to return excess sales tax reimbursement to either the customer or the State Board is the retailer receiving "notification by the Board of Equalization or by the customer that such excess has been ascertained." *Loeffler* holds, however, that the State Board has the sole authority to "ascertain" such matters. *Loeffler* at 1123 ("it is the Board that 'ascertains' whether a retailer has charged excess reimbursement on a sale."). Moreover, consumers are powerless to compel the Board or the retailer to do anything. *Id.* at 1120 ("Section 6901.5 provides no procedure by which consumers can require the Board to 'ascertain' whether excess reimbursement has in fact been charged, nor is there a statutory procedure by which the consumer can make certain that the retailer will be ordered to refund an excess amount to the consumer."). *Loeffler* even acknowledges, and tacitly approves, retailers' bias in favor of overcharging consumers. *Id.* at 1129 ("[I]t would not be unreasonable if the retailer's tax payment to some extent erred on the side of considering sales taxable.").

Thus, retailers—whose bias "erred on the side of considering sales taxable," who overcharged consumers sales tax reimbursement in the first place, and who "have no particular interest in pursuing a tax refund" (*see supra* Section I)—are nevertheless put in control of determining whether to return any refunds to customers or back to the State Board. That itself is a facial violation of Due Process. *See, e.g.*, *Fuentes v. Shevin*, 407 U.S. 67, 93 (1972) ("*Fuentes*") ("The statutes, moreover,

abdicate effective state control over state power. Private parties, serving their own private advantage, may unilaterally invoke state power to replevy goods from another.").

Retailers have a strong incentive to always remit excess sales tax reimbursement to the State rather than to consumers. First, returning excess sales tax reimbursement to customers might involve incurring some inconvenience and expense. Second, *Loeffler* held that "section 6901.5 provides a safe harbor for a retailer/taxpayer who remits reimbursement charges to the Board" (*Loeffler* at 1100) making it legally safer for the retailer to remit to the State.

But in fact, things never get to that point because the State Board never "ascertains" whether excess sales tax reimbursement has been remitted unless compelled to do so by a retailer's tax refund claim, and retailers never file such claims. *See supra* Sections J and I.

Subject 3: The Accounting for Excess Sales Tax Reimbursement

The final phrase of §6901.5 describes the accounting for excess sales tax reimbursement once it is remitted to the State:

> [A]mounts remitted to the state shall be credited by the board on any amounts due and payable under this part on the same transaction from the [retailer] by whom it was paid to

> this state and the balance, if any, shall constitute an obligation due from the [retailer] to this state.

Excess sales tax reimbursement, by definition, can only arise when a retailer charges a consumer "reimbursement" in an amount greater than the retailer's sales tax liability "on the same transaction." According to the final phrase of §6901.5, such excess amounts once "remitted to the state shall be credited by the board on any amounts due and payable under this part on the same transaction." That creates a "balance" from the "same transaction" that could be either negative or positive from the State's perspective.

The "balance" would be negative if the retailer remitted less than the amount of tax owed on the transaction (notwithstanding having collected more than that amount from the consumer as "reimbursement.") The "balance" would be positive if the retailer remitted all the sales tax owed on the transaction plus *any* of the excess sales tax reimbursement collected from the consumer.

Under §6901.5, regardless of whether the retailer's account balance on the transaction is negative or positive, "the balance, if any, shall constitute an obligation due from the [retailer] to this state." Thus, a negative "balance" remains an "obligation due from the [retailer] to this state." The retailer nevertheless benefits from remitting the consumer's excess sales tax reimbursement to the State because that serves to reduce the negative "balance" on the retailer's account.

Where the "balance" on the transaction is positive, on the other hand, the State receives a windfall unless the retailer elects to return the balance to its customers, which a retailer would never do owing to the expense and inconvenience involved. The State therefore receives all the sales tax that was owed on the transaction plus the positive "balance" resulting from the retailer overcharging the consumer.

The State has no conceivable constitutional justification for retaining a fictional "balance" of the "obligation due from the [retailer] to this state." Rather, it is a "taking" from the consumer and, when done without a right to a hearing, is facially unconstitutional under the Due Process Clause. *See*, *e.g.*, *Fuentes*, 407 U.S. at 80 ("For more than a century the central meaning of procedural due process has been clear: 'Parties whose rights are to be affected are entitled to be heard.'").

L. The State's Exaction of Excess Sales Tax Reimbursement Is Accomplished Through an Unconstitutional Escheat, Not Taxation

Tax Code §6901.5 is an escheat statute embedded in a sales tax law, albeit one that lacks the due process protections required for a constitutional escheat. The State has judicially admitted that "section 6901.5 is a tax statute that ensures that retailers do not wrongfully retain excess sales tax reimbursement paid by customers." State Board's Answer to Petition for Review, 5/15/2017, p.15. Preventing unjust enrichment is often the purpose of escheat statutes involving three or

more parties: (1) a stakeholder (the retailer) having no ownership right to the property, (2) one or more possible rightful owners of the property (the customers), and (3) the State, which claims the right to escheat the property so as to avoid unjust enrichment of the stakeholder (the retailer).

Such relationships commonly arise in the banking industry and in California are governed by the unclaimed property laws. (*See* Cal. Code Civ. Proc. §1300 et seq. and §1500 et seq.) A common fact pattern is where a bank is the stakeholder for a customer's dormant savings account. The bank' s customer is the rightful owner of the account, but the customer's whereabouts are unknown. The State is the sovereign which claims the right to escheat the money in the savings account so as to avoid unjustly enriching the bank.

Note that the bank in the unclaimed property context typically holds only money which it has the option of returning to the rightful owner if locatable. Alternatively, the bank is required to escheat the money to the state. The State does not directly take the money from the rightful owner of the property. Instead, the rightful owner of the property (the customer) has already transferred the money to the bank (the stakeholder) in a private contractual transaction, and when the account becomes dormant the bank pays the money to the state in a second sequential step. Thus, the privity structure between the three parties (rightful owner, stakeholder, and state) is identical in the unclaimed property context to that under Tax Code §6901.5 (consumer, retailer, and State).

Additionally, under §6901.5 the excess sales tax reimbursement must be either "returned by the person [*i.e.*, the retailer] to the customer" or "remitted by that person to this state." If Tax Code §6901.5 were designed to raise tax revenue, there would be no reason to provide retailers with the option of returning the excess sales tax reimbursement to customers, since that would defeat the goal of raising tax revenue. It is therefore clear that Tax Code §6901.5 is an escheat statute, not a taxation statute.

M. The State's Rationale for Denying Standing to Consumers Is Flawed and Results in a Facial Denial of Due Process

Capitalizing on the fact that consumers are not legally recognized as "taxpayers," the State has stridently denied standing to any consumers seeking to obtain a return of the excess sales tax reimbursement. The striking fact, however, is that the State's rationale for denying consumers standing—that only the retailer is the "taxpayer"—is built on a logical disconnect. As shown above (*see supra* Section G), sales tax reimbursement is not a "tax," so why does it matter that consumers are not "taxpayers" when they are not seeking the refund of any "tax," but rather seek restitution from the State to remedy its unjust enrichment? The State courts have never addressed this logical flaw that results in a facial violation of the "central meaning of procedural due process" which is that "Parties whose rights are to be affected are entitled to be heard." *Fuentes*, 407 U.S. at 80.

REASONS FOR GRANTING THE PETITION

The California Supreme Court's Decision on the Due Process Clause Conflicts with Multiple Decisions of This Court

Entirely missing from the California Supreme Court's opinion is the identification of any affirmative legal principle to justify the State's confiscation of consumers' private property. The State's confiscation cannot be justified as taxation because excess sales tax reimbursement is not a "tax." *See supra* Section G. Nor is excess sales tax reimbursement a fine, fee, or civil asset forfeiture related to criminal conduct. That only leaves escheat, which shares the same purpose of avoiding unjust enrichment as Civil Code §6901.5. *See supra* Section L. But as stated by Judge Posner in *Cerajeski v. Zoeller*, 735 F.3d 577, 582 (7th Cir. 2013): "[A] state may not escheat property without a judicial or administrative determination that the property has been abandoned or is otherwise subject to escheat. Everything required for an escheat is missing in this case." Judge Posner's statement is equally true here. Everything required for a *constitutional* escheat is missing in this case.

The opinion states that "Nothing in the sales tax statutes establishes that consumers have a vested right to applicable exemptions." App.14. That argument is a strawman. The question is not whether consumers have a vested right to applicable exemptions, but rather whether consumers have a right to recover overcharges of sales tax reimbursement that they paid

under whatever exemption was legally applicable at the time of the payment.

Moreover, under this Court's rulings, property owners do have constitutionally vested rights to private property under the Takings Clause. *See Stop the Beach Renourishment, Inc. v. Fla. Dep't of Envtl. Prot.*, 560 U.S. 702, 702-05 (2010) ("If a legislature or a court declares that what was once an established right of private property no longer exists, it has taken that property, no less than if the State had physically appropriated it or destroyed its value by regulation."). Here, consumers' "established right of private property" in the form of sales tax reimbursement was recognized by the State Board and the California Supreme Court in *Decorative Carpets* in 1962 and was statutorily recognized as being created by private contract with the adoption of Civil Code §1656.1 in 1978. *See supra* Sections H and E. Those events occurred twenty years and four years respectively before enactment of Tax Code §6901.5 in 1982.

The opinion states that "plaintiffs may have other avenues to obtain a determination of the taxability question at the heart of their complaint." App.13-14. It cross-references to a paragraph where the opinion cites a number of California statutory and regulatory provisions. App.11-12. However, even the Court of Appeal described those statutory and regulatory provisions as being "the practical equivalent of allowing [Petitioners] to tug (albeit persistently) at the Board's sleeve." App.54. Indeed, the California Supreme Court's *Loeffler* opinion was more candid than its current

opinion when it stated: "Section 6901.5 provides no procedure by which consumers can require the Board to 'ascertain' whether excess reimbursement has in fact been charged, nor is there a statutory procedure by which the consumer can make certain that the retailer will be ordered to refund an excess amount to the consumer." *Loeffler* at 1120.

Moreover, none of the provisions identified in the opinion provide for compensation. That makes the provisions a "constitutionally insufficient remedy" under *First English*, 482 U.S. at 321-22 ("[W]e hold that invalidation of the ordinance without payment of fair value for the use of the property during this period of time would be a constitutionally insufficient remedy."). *See also Williamson*, 473 U.S. at 194 ("all that is required [by the Fifth Amendment] is that a 'reasonable, certain and adequate provision for obtaining compensation' exist at the time of the taking.").

Justice Alito and Thomas, in their concurrence to the denial of certiorari in *Taylor v. Yee*, described the broad reach of the Due Process Clause with respect to States "seizing private property":

> The petition in this case asks us to decide whether the California law provides property owners with constitutionally sufficient notice before escheating their financial assets. The Due Process Clause requires States to give adequate notice before seizing private property. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313, 70 S.Ct. 652, 94 L. Ed. 865 (1950) (Although "[m]any controversies have

> raged about the cryptic and abstract words of the Due Process Clause," that provision undoubtedly requires that, before seizing private property, the government must give "notice and opportunity for hearing appropriate to the nature of the case").

Taylor v. Yee, 136 S.Ct. at 929. *See also Fuentes*, 407 U.S. at 67, which recognizes the same due process rights to "notice and opportunity for hearing" even when the seizure of private property does not financially benefit the State (as it does here).

California, however, gives consumers no "notice and opportunity for hearing" with respect to confiscation of excess sales tax reimbursement. Rather, California has baldly done exactly what the Constitution forbids:

> [A] State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit in court. This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent. That Clause stands as a shield against the arbitrary use of governmental power.

Webb's Fabulous Pharmacies v. Beckwith, 449 U.S. 155, 164 (1980) ("*Webb's*").

The California Supreme Court's Decision on the Takings Clause Conflicts with Multiple Decisions of This Court

Quite apart from the State's due process violations, it is well settled that permanent escheats are subject to the Takings Clause. *See, e.g.*, *Hodel v. Irving*, 481 U.S. 704, 717 (1987) ("Since the escheatable interests are not, as the United States argues, necessarily de minimis . . . a total abrogation of these rights cannot be upheld."); *Webb's*, 449 U.S. at 164 ("a State, by *ipse dixit*, may not transform private property into public property without compensation. . . . This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent"); *Phillips*, 524 U.S. at 167 ("[A]t least as to confiscatory regulations (as opposed to those regulating the use of property) a State may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law.")

The fact that the State could have imposed the sales tax incidence on consumers (but chose not to do so) does not prevent application of the Takings Clause. *See Koontz v. St. Johns River Water Management District*, 133 S.Ct. 2586, 2601 (2013) ("[W]e have repeatedly found takings where the government, by confiscating financial obligations, achieved a result that could have been obtained by imposing a tax.")

The State's "taking" of excess sales tax reimbursement under Tax Code §6901.5 operates as a "physical taking" (rather than a "regulatory taking" such as a

land use regulation). Physical takings amount to a *per se* taking for which victims are entitled to just compensation without "complex factual assessments of the purposes and economic effects of government actions." (*Brown v. Legal Foundation*, 538 U.S. 216, 233-34 (2003). *See also Koontz*, 133 S.Ct. at 2600 ("[W]hen the government commands the relinquishment of funds linked to a specific, identifiable property interest such as a bank account or parcel of real property, a 'per se takings approach' is the proper mode of analysis under the Court's precedent.").

Nevertheless, citing no authority, the California Supreme Court's opinion summarily rejected Petitioners' Takings Clause arguments for two reasons contained in a single paragraph. The first reason is as follows:

> But even if the state's retention of amounts that have been judicially or administratively determined to be excess sales tax reimbursement could be regarded as a taking, no such determination has been made here. App.15.

The above sentence is circular, bootstrap logic. It states that because no amounts *have been* judicially or administratively determined to be excess sales tax reimbursement, Petitioners have no right to any proceeding by which such facts *could be* judicially or administratively determined. That logic would justify denying any claim for any type of wrong (*i.e.*, if plaintiff has not already judicially or administratively proven its claim, it has no right to any procedure by which it could judicially or administratively prove its claim.)

Such logic is surely the ultimate denial of due process. It conflicts with this Court's *Fuentes* decision at 87 ("The right to be heard does not depend upon an advance showing that one will surely prevail at the hearing") and countless other decisions of this Court, including *First English*, 482 U.S. at 313 ("These questions, of course, remain open for decision on the remand we direct today."). Indeed, it is ironic that the California Supreme Court's opinion rejected Petitioners' Takings Clause claim because amounts of excess sales tax reimbursement "have [not] been judicially or administratively determined" when the very purpose of Petitioners' *Javor* claim—which the Supreme Court also rejected—was to compel the State Board to make such a determination.

The California Supreme Court's second reason for rejecting Petitioners' Takings Clause claim is as follows:

> And the absence of a legislatively or judicially created refund action to compel such a determination does not itself constitute a taking. App.15.

The above statement squarely conflicts with this Court's decision in *Williamson*, 473 U.S. at 194:

> Nor does the Fifth Amendment require that just compensation be paid in advance of, or contemporaneously with, the taking; *all that is required is that a "reasonable, certain and adequate provision for obtaining compensation" exist at the time of the taking*. (emphasis added.)

As is now apparent, "at the time of the taking," and at all times thereafter, the State has denied consumers a "reasonable, certain and adequate provision for obtaining compensation." That is an unconstitutional taking under *Williamson* as well as the other authorities cited above. The remedy is clear. As held by this Court in *First English*, 482 U.S. at 322:

> We merely hold that where the government's activities have already worked a taking of all use of property, no subsequent action by the government can relieve it of the duty to provide compensation for the period during which the taking was effective.

CONCLUSION

The instant opinion from the highest court in the nation's most populous state should not be allowed to stand. Its rationale for denying Petitioners leave to allege a constitutional Takings Clause claim—that since plaintiffs *have not already* judicially or administratively proven their Takings Clause claim, they have no right to any procedure *by which they could* prove that claim—conflicts with a multitude of Due Process decisions by this Court including *Fuentes*. Likewise, the opinion's implicit validation of a State statutory scheme that rejects the real-party-in-interest rule and systematically confiscates private property in the form of excess sales tax reimbursement conflicts with Due Process, the Takings Clause, and the opinions

of this Court, including *Hodel, Webb's, Phillips, Koontz, Brown*, *Williamson*, and *First English*.

This case also offers an extraordinarily clean record for this Court to review the constitutionality of State escheat practices because (i) it arises from a demurrer without leave to amend, (ii) the constitutional claims were preserved in the courts below, and (iii) the remedy is simply to instruct those courts to grant Petitioners leave to amend to allege a constitutional Takings Clause claim. This Petition for Writ of Certiorari should therefore be granted.

Respectfully submitted,

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