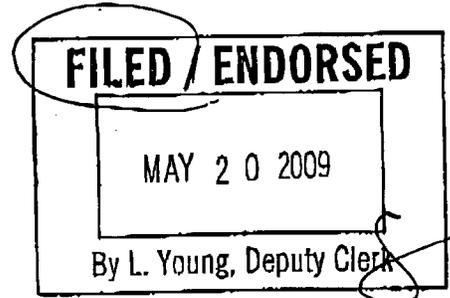


Department 29
Superior Court of California
County of Sacramento
720 Ninth Street
Timothy M. Frawley, Judge
Lynn Young, Clerk



Hearing Held: Friday, May 8, 2009, 1:30 p.m.

<p>CALIFORNIA TAXPAYERS' ASSOCIATION</p> <p>v.</p> <p>CALIFORNIA FRANCHISE TAX BOARD, et al.</p>	<p>Case Number: 34-2009-80000168</p>
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Proceedings: Petition for Writ of Mandate and Verified Complaint for Injunctive Relief and Declaratory Judgment

Filed By: Amy Silverstein, Silverstein & Pomerantz LLP, Attorneys for Petitioner

On May 7, 2009, the Court issued a tentative ruling in the above-entitled proceeding. On May 8, 2009, the above-entitled cause came on for hearing with counsel present as indicated on the record. The matter was argued and submitted. Having taken the matter under submission, the Court now rules as follows:

RULING AFTER HEARING

This Petition for Writ of Mandate and Verified Complaint for Injunctive Relief and Declaratory Judgment (the "Petition"), filed by Petitioner California Taxpayers' Association ("CalTax"), challenges the constitutionality of California Revenue and Taxation Code section 19138, which was added by section 5 of Senate Bill X1 28 ("SB X1 28"), and became effective on December 19, 2008.

Section 19138 purports to impose a "penalty" on any corporate taxpayers with an understatement of tax in excess of one million dollars (\$1 million) for any taxable year. The penalty is equal to twenty percent (20%) of the total amount of the understatement, which is measured by the difference between the correct tax liability and the tax reported on the taxpayer's "original return."

Taxpayers required to be included in a combined report under Revenue and Taxation Code section 25101, or authorized to be included in a combined report

under Revenue and Taxation Code section 25101.15, are combined and treated as a single entity for purposes of determining whether the understatement exceeds \$1 million.

Section 19138 applies retroactively to each taxable year beginning on or after January 1, 2003, for which the statute of limitations on assessment has not expired. However, a taxpayer may reduce the likelihood of an underpayment penalty for prior taxable years by filing an amended return. For the 2003-2007 taxable years, if a taxpayer files an amended return and pays the tax shown on the amended return by May 31, 2009, the taxpayer may treat the tax shown on the amended return as the tax shown on the "original return" for purposes of determining any understatement of tax.

There are two express exceptions to liability under section 19138: no penalty shall be imposed where the understatement is attributable to (1) specified changes in law, or (2) the taxpayer's reasonable reliance on a legal ruling by the Chief Counsel of FTB.

The procedures of the Revenue and Taxation Code governing deficiency assessments – including the protest and appeal procedures – do not apply to the assessment and collection of penalties under section 19138. Further, section 19138, subdivision (e) provides that a refund or credit for any amounts paid to satisfy a penalty imposed under section 19138 "may be allowed only on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board."

Petitioner CalTax is a non-profit organization founded to protect individual and corporate taxpayers from unnecessary taxes and to promote government efficiency. CalTax alleges that included among its members are more than 200 corporations subject to California franchise or income tax laws, many of whom pay franchise or income taxes in excess of \$1 million and regularly report or receive assessments of California income or franchise taxes in excess of \$1 million in the ordinary course of their businesses.

CalTax's Complaint, filed on February 17, 2009, challenges the constitutionality of section 19138.

The Complaint contains six causes of action. The First Cause of Action alleges that section 19138 violates article XIII A, § 3 of the California Constitution because section 19138, while termed a penalty, in substance imposes a tax that was not approved by two-thirds of all members elected to each of the two houses of the Legislature. The Second Cause of Action alleges that section 19138 violates article IV, § 8(b) of the California Constitution because SB X1 28 (which enacted section 19138) was not "printed and distributed" to the members of the Assembly and Senate before it was passed, and because the Senate failed to "read the bill by title" on three separate days or to dispense with this requirement

by a two-thirds roll call vote. The Third, Fourth, and Fifth Causes of Action allege that section 19138 violates the Due Process, Equal Protection, and Commerce Clause of the United States Constitution, respectively, because, among other reasons, it (a) affords no prepayment or post-payment review; (b) operates retroactively for an excessive period of time (c) fails to give clear notice of what conduct it seeks to prohibit; (d) treats individual corporations different than combined groups of "unitary" corporations; and (e) disproportionately burdens interstate commerce. The Sixth Cause of Action seeks declaratory relief that section 19138 is illegal and invalid for each of the reasons set forth above. CalTax seeks a declaration that section 19138 is unconstitutional on its face and a judgment enjoining its enforcement.

Respondent Franchise Tax Board ("FTB") previously demurred to the Complaint on the grounds the Court lacks subject matter jurisdiction over the claims and the Complaint fails to allege facts sufficient to constitute a cause of action for injunctive, declaratory, or mandamus relief. Specifically, FTB argued that (1) CalTax lacks standing to bring this lawsuit; (2) CalTax's challenge to section 19138 is not ripe for judicial review; and (3) CalTax's claims are barred by the constitutional "pay first, litigate later" rule, the doctrine of exhaustion of administrative remedies, and the doctrine of adequate legal remedies. The Court overruled FTB's demurrer.

Requests for Judicial Notice and Evidentiary Objections

The Court sustains FTB's objection to the declaration of Teresa Casazza. All other evidentiary objections are overruled.

The Court denies CalTax's request for judicial notice of Exhibits A, B, K, L, M, N, and P. The Court grants CalTax's request for judicial notice of Exhibits C-J, O, Q-R, F-1 and G-1, and FTB's request for judicial notice of Exhibit 1, but only for the limited purpose of considering (i) whether the exaction functions as a penalty or a tax; (ii) whether the effect of section 19138 is to discriminate against multi-state corporations; and (iii) whether, if the Enrolled Bill Rule does not apply, the Legislature nevertheless substantially complied with article IV, section 8(b) of the California Constitution. In all other respects, the requests for judicial notice are denied.

Discuss on

The issues presented in this proceeding are as follows:

1. Did the enactment of section 19138 violate California Constitution, article XIII A, section 3 ["Proposition 13"] because the "penalty" is, in effect, a "tax" or a "change in State taxes" that was not passed by at least two-thirds of all members of each house of the Legislature?

2. Did the enactment of section 19138 violate California Constitution, article IV, section 8(b) because the Senate dispensed with the constitutional "reading requirement" by resolution without a two-thirds roll-call vote, and/or because the bill was not printed and distributed to the members of the Senate and Assembly before voting?
3. Is section 19138 facially unconstitutional under the Excessive Fines Clause of the Eighth Amendment because the amount of the purported penalty – 20% of the amount of any understatement of tax – is grossly disproportionate to the gravity of the "offense?"
4. Is section 19138 facially unconstitutional under the substantive due process guarantees of the Fourteenth Amendment because it fails to give fair warning of the conduct it requires and/or because it applies retroactively to each taxable year beginning on or after January 1, 2003?
5. Is section 19138 facially unconstitutional under the procedural due process guarantees of the Fourteenth Amendment because it denies any pre- or post-payment review and therefore does not provide taxpayers with a fair opportunity to contest the legality of the penalty?
6. Is section 19138 facially unconstitutional under the Commerce Clause because it discriminates against multi-state corporations by employing a more favorable method for determining when the levy applies for intra-state corporations than for inter-state corporations?
7. Is section 19138 facially unconstitutional under the Equal Protection Clause because it discriminates against inter-state businesses in favor of similarly situated intra-state businesses?

The Court addresses each issue separately below.

A. California Constitution, article XIII A, section 3 [Proposition 13]

CalTax alleges that section 19138, although nominally a "penalty," is, in fact, a "tax," constitutionally required to be passed by at least two-thirds of the members of each house of the Legislature. Because it is undisputed that section 19138 was not passed by two-thirds of the members of the Assembly and Senate, CalTax alleges section 19138 violates article XIII A, section 3 of the California Constitution.

As an initial matter, the Court must decide which party has the burden of proof in determining whether the challenged exaction is a valid penalty or an unconstitutional tax.

The Court is not aware of any cases directly deciding this issue, although a number of courts have wrestled with the issue of who has the burden of proof in determining whether an imposition is a valid fee or an unconstitutional tax, with

varying results. (See, e.g., *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, 235-236 [local agency seeking to invoke exception to Proposition 13 held to have burden of establishing fee fits the exception]; *Knox v. City of Orland* (1992) 4 Cal.4th 132, 147-148 [refusing to apply *Beaumont* to case involving benefit assessments], superseded by statute as stated in *Not About Water Com. v. Board of Supervisors* (2002) 95 Cal.App.4th 982; *Sea & Sage Audobon Soc'y v. Planning Com.* (1983) 34 Cal.3d 412, 421 [finding plaintiff had initial burden of presenting a prima facie evidentiary showing as to the invalidity of the fee].)

In *Beaumont Investors v. Beaumont-Cherry Valley Water District* (1985) 165 Cal.App.3d 227, the Fourth Appellate District Court of Appeal held that the government bears the burden of proving that a development fee is exempt from Proposition 13. (*Beaumont Investors v. Beaumont-Cherry Valley Water Dist.* (1985) 165 Cal.App.3d 227, 235-236.) According to the court in *Beaumont*, because the purpose of Proposition 13 was to impose a broad constitutional restriction on the power of local agencies to impose "special taxes," subject only to a limited statutory exception for fees which are reasonably related to the cost of the service for which they are imposed, it follows that the local agency which seeks to avoid the general rule "should have the burden of establishing that it fits the exception." (*Id.* at p.235.) Because the district in *Beaumont* had failed to develop a record from which costs reasonably related to the development fee could be determined, the court concluded it was required to hold that the fee constituted a "special tax." (*Id.* at p.238.)

The holding in *Beaumont* has been followed by other courts of appeal in determining whether a state or local fee is, in legal effect, a special tax under Proposition 13. (See *California Ass'n of Prof. Scientists v. Dept. of Fish & Game* (2000) 79 Cal.App.4th 935, 945 [in a challenge to regulatory fee, government bears burden of establishing the estimated costs of the regulatory activity and the basis for determining the manner in which costs are apportioned, so that charges allocated to payor bear a fair or reasonable relationship to payor's burdens/benefits from the regulatory activity]; *City of Dublin v. County of Alameda* (1993) 14 Cal.App.4th 264, 281-282 [when a fee-for-services ordinance or resolution is challenged as a special tax, the burden is on the local agency to produce evidence in support of its determination that those fees will not exceed the reasonable cost of the service to be provided]; *Bixel Assocs. v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1216 [following *Beaumont* in action challenging fire hydrant fee]; *San Diego Gas & Elec. Co. v. San Diego Air County Pollution Control Dist.* (1988) 203 Cal.App.3d 1132, 1146 [following *Beaumont* in action challenging air pollution permit fee].)

However, in *Knox v. City of Orland* (1992) 4 Cal.4th 132, the California Supreme Court cast substantial doubt about the propriety of shifting the burden of proof to the agency. (*Brydon v. E. Bay Mun. Util. Dist.* (1994) 24 Cal.App.4th 178, 191.) In *Knox*, the California Supreme Court ruled that the party attacking a special

benefit assessment as an invalid special tax: has the burden of proof. (*Knox, supra*, at p.147.) The Court reasoned that, unlike the fee at issue in *Beaumont*, the challenged assessment was not "presumptively a special tax" under California Constitution article XIII A, section 4 [Proposition 13]. (*Id.*) The Court found no reason to "deviate from the traditional standard of review" requiring the party attacking legislation to prove it is invalid.

Similarly, in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866, the California Supreme Court cited the general rule that "persons challenging fees have [the] burden of establishing [their] invalidity." (*Id.* at p.877.) The Supreme Court reversed a summary judgment against the Board of Equalization for a refund of fees paid pursuant to an assessment under the Childhood Lead Poisoning Prevention Act of 1991, which had concluded that the fees were in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature under Proposition 13. Although the Supreme Court referred to *Beaumont* in its decision, the Court, in remanding the case to the trial court, clearly placed the burden of proof on the party challenging the assessment, not the government. (*Id.* at p.881 ["Sinclair should be permitted to attempt to prove at trial that the amount of fees assessed and paid exceeded the reasonable cost of providing the protective services for which the fees were charged, or that the fees were levied for unrelated revenue purposes"].)

At least one appellate court decision has construed *Sinclair* as placing the burden of proof in a "fee" case on the plaintiff. (*Townzen v. County of El Dorado* (1998) 64 Cal.App.4th 1350, 1359 [finding plaintiff failed to establish that court filing fees are special taxes subject to the two-thirds requirement of Proposition 13]; *but see California Ass'n of Prof. Scientists, supra*, 79 Cal.App.4th at p.945.)

This Court construes *Knox* and *Sinclair* as placing the burden of proof on the taxpayer, not the government.

This Court construes the *Beaumont* line of cases to mean only that the government bears the burden of producing an adequate record to ensure governmental compliance with the statutory exception contained in Government Code section 50076. Moreover, even if *Beaumont* stands for a broader shifting of the burden of proof, it is clearly limited to the context of development and regulatory fees. Thus, case law supports the conclusion that CalTax has the burden of proof to show that the challenged exaction is an unconstitutional tax.

The history of Proposition 218 also supports this conclusion.

In 1996, voters enacted Proposition 218, adding articles XIII C and XIII D to the California Constitution. Proposition 218 buttresses Proposition 13's limitations on property and special taxes by placing analogous restrictions on assessments, fees, and charges. (*Apt. Ass'n of L.A. County v. City of L.A.* (2001) 24 Cal.4th 830, 837.)

The drafters of Proposition 218 were aware of the Supreme Court's decision in *Knox* and sought to make it more difficult for an assessment to be validated in a court proceeding. (*Silicon Valley Taxpayers' Assn., Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 444.) The drafters of Proposition 218 therefore included a provision reversing the usual presumption of validity of local assessments by placing the "burden of proof" on the local government agency. (*Id.* at p.445.) Proposition 218 provides, in relevant part:

In any legal action contesting the validity of any assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, the benefits conferred on the property or properties in question. (Cal. Const. art. XIII D, § 4(f).)

This change was explained in the Legislative Analyst's analysis of the measure, as follows: "In lawsuits challenging property fees and assessments, the taxpayer generally has the 'burden of proof' to show that they are not legal. This measure shifts the burden of proof in these lawsuits to local government." (*Id.*)

Important here is that there is no similar burden-shifting language in Proposition 13. Accordingly, in Proposition 13 cases, there is no reason to deviate from the general rule described by the California Supreme Court in *Knox*, especially where, as here, the taxpayer is not challenging a regulatory or development fee.

For all of these reasons, the Court concludes that it is CalTax's burden to show that the challenged exaction is an unconstitutional tax. CalTax has not met its burden of proof in this case.

In determining whether an exaction is a tax or penalty, CalTax contends that the Court should focus on the underlying legislators' motivation for approving the exaction. The Court declines this invitation since it would violate the longstanding principle barring judicial inquiry into legislative motivation. (See, e.g., *Conn. Indem. Co. v. Superior Court* (2000) 23 Cal.4th 807, 814.)

The Court also rejects CalTax's suggestion that the Court should ignore the legislative designation of the exaction. In the Court's view, the test for determining whether an exaction is a tax or penalty requires the Court to consider both the intended purpose of the exaction as well as its actual effects.

To ascertain the intended purpose of an exaction, the Court must consider the legislative designation. It is hornbook law that to determine what a statute means, courts first consult the words of the statute itself, giving the words their usual and ordinary meaning. When statutory language is clear and

unambiguous, the plain meaning of the language controls. (*Delaney v. Superior Court* (1990) 50 Cal.3d 785, 800.)

In this case, the plain language of the statute is clear and unambiguous that the Legislature intended the exaction to be a "penalty." Accordingly, there is no need to consider extrinsic indicia of legislative intent.

Moreover, even if two alternative interpretations were possible, the Court would be required to choose the construction which would uphold its constitutionality. Since construing the "understatement penalty" as a tax would render the statute unconstitutional, this rule of statutory construction also supports the conclusion that the Legislature intended the exaction to be a penalty.

The legislative designation shows that the Legislature intended the exaction to be a penalty, and this is persuasive evidence that the exaction is a penalty. (See *Weekes v. Oakland* (1978) 21 Cal.3d 386, 392 [while the legislative designation of the exaction is not conclusive, it is persuasive].)

Of course, this is not the end of the Court's inquiry. If an exaction is in its nature a tax, it cannot be converted to a penalty simply by calling it such.

Thus, in determining the nature of the exaction, the Court must look behind the legislative designation of the exaction and examine how the exaction actually functions. This functional analysis looks at the "actual effects" of the exaction and asks whether the exaction functions as a penalty or a tax.

The difference between a tax and a penalty is not always clear. As the California Supreme Court acknowledged in *Sinclair Paint*, the term "tax" has no fixed meaning. (*Sinclair Paint, supra*, 15 Cal.4th at pp.874.) In general, however, taxes are defined as compulsory contributions which raise revenues for general governmental purposes, whereas a penalty is defined as an exaction imposed to regulate conduct by prohibiting, punishing, or discouraging a particular act or omission. (*Id.*; see also *Child Labor Tax Case* (1922) 259 U.S. 20, 38.) Still, it is not uncommon for taxes to have the dual purposes of raising revenue and regulating (discouraging) conduct. Indeed, almost all taxes have a regulatory effect, even if this is unintentional.

Likewise, nearly all penalties have the (intended or unintended) effect of raising revenue. (*Sinclair Paint, supra*, 15 Cal.4th at pp.874, 880.) If all fees and assessments that exact money for public purposes were "taxes," then all fees, assessments, surcharges, etc. would be subject to the two-thirds majority required by Proposition 13. Obviously, this is not the case.

Accordingly, the Court must engage in the sometimes slippery business of weighing the relative importance of the penal and revenue-raising effects to determine the true nature of the exaction. If the primary function of the exaction

is to regulate (punish) conduct, it is properly characterized as a penalty; but if the primary function is to raise revenue, it is properly characterized as a tax. Towards that end, there is one important distinction between a penalty and a tax: while a tax raises revenue if it is obeyed, a penalty raises revenue only if some legal obligation is disobeyed.

The exaction at issue here is imposed only if a taxpayer has an understatement of tax in excess of one million dollars in a taxable year. Although the exaction clearly will have revenue-raising effects, the primary function of the exaction is to deter and punish understated returns. The fact that the exaction lacks the "good faith" exceptions that often accompany tax penalties does not alter this conclusion.

CalTax has not met its burden to prove that section 19138 violates Proposition 13.

Moreover, the Court would reach this same conclusion that the challenged exaction is a penalty, and not an illegal tax, regardless of how the burden of proof is assigned.

B. California Constitution, article IV, section 8(b)

CalTax also argues that the enactment of section 19138 is unconstitutional because the Legislature failed to adhere to the procedures required by article IV, section 8(b) of the California Constitution, namely the "reading" and "printing and distribution" requirements.

FTB argues that CalTax's challenge must be denied based on the "Enrolled Bill Rule."

The Enrolled Bill Rule concerns the nature of the evidence a court may consider in determining whether a bill was validly adopted. (See *United States Nat'l Bank v. Independent Ins. Agents of America* (1993) 508 U.S. 439, 455 [citing *United States v. Munoz-Florez* (1990) 495 U.S. 384, 391 fn.4].) The Rule provides that if an act of the Legislature is properly enrolled, authenticated, and filed, it is conclusively presumed that all of the steps required for its passage were properly taken, and extrinsic evidence is not admissible to impeach it. The Rule permits judicial inquiry only if an irregularity in the legislative process appears on the face of the enrolled legislation. If a legislative document is authenticated in regular form, the Rule requires the courts to treat the legislation as properly adopted.

In many ways, the Enrolled Bill Rule is an historical relic. The Rule was adopted in the nineteenth century, at a time when legislative record-keeping was undependable and inadequate. (See Ittai Bar-Siman-Tov, *Legislative Supremacy in the United States?: Rethinking the "Enrolled Bill" Doctrine* (2009) 97 Geo. L.J. 323, 331 [hereafter "Bar-Siman-Tov"]; David Sandler, *Forget What You Learned*

in Civics Class: The "Enrolled Bill Rule" and Why It's Time to Overrule Field v. Clark (2007) 41 Colum. J.L. & Soc. Probs. 113, 221-222 [hereafter "Sandler".] Courts were concerned that allowing litigants to impeach the text of an enrolled bill based on the "loose papers of the legislature" would create uncertainty in the laws and require courts to conduct inquiries that would impinge on the "respect" due to a coequal branch of the government. (See *Marshall Field & Co. v. Clark* (1892) 143 U.S. 649, 672, 675.)

Modern commentators have noted that, given improvements in legislative record-keeping and other technological developments, the original justifications for the Enrolled Bill Rule are now constitutionally and empirically suspect. (See Bar-Siman-Tov, *supra*, at pp.334-335; Sandler, *supra*, at pp.233-240.)

The most fundamental criticism of the Rule is that it represents an impermissible delegation of judicial powers to the legislative branch because the practical effect of the Rule is to cede to legislative officers the authority to determine the constitutional validity of legislation. (See Bar-Siman-Tov, *supra*, at pp.333, 358-362; Sandler, *supra*, at pp.214, 233-235, 246.) The Enrolled Bill Rule essentially forces courts to ignore constitutional violations and treat statutes as valid even in the face of clear and reliable evidence to the contrary. (*Id.*) There is no exception to the doctrine even if members of the Legislature openly and deliberately violate constitutional lawmaking requirements. Because the Rule effectively precludes judicial review of the legislative process, commentators have argued that the Rule permits, and perhaps even encourages, disregard of constitutional lawmaking requirements.¹ (*Id.*)

The critics of the Enrolled Bill Rule raise powerful arguments that continued reliance on the Rule is no longer justified, at least where litigants are alleging that the Legislature failed to adhere to constitutional provisions relating to the enactment of laws, as distinguished from the Legislature's own internal procedural rules. It is, after all, the duty of the courts, not the Legislature, to interpret and give effect to the provisions of the constitution, including those relating to the enactment of laws. (See *Marshall Field & Co. v. Clark* (1892) 143 U.S. 649, 670.)

In its tentative ruling, the Court questioned whether the "Enrolled Bill Rule" continues to be good law in California.

The Court has granted the California State Senate's request to file an amicus curiae brief regarding the Enrolled Bill Rule. In its brief, the Senate argues that the Rule continues to govern the relations between the legislative and judicial branches with respect to matters of legislative procedure. (See *De Asis v. Dept. of Motor Vehicles* (2003) 112 Cal.App.4th 593, 600-601; *Longval v. Workers' Comp. Appeals Bd.* (1996) 51 Cal.App.4th 792, 804; *Pulskamp v. Martinez*

¹ These constitutional concerns would be heightened in a case in which the Legislature was accused of violating constitutional requirements adopted by the initiative process.

(1991) 2 Cal.App.4th 854, 865; *Planned Parenthood Affiliates of California v. Swoap* (1985) 173 Cal.App.3d 1187, 1193-1195; cf. *People ex rel. Levin v. County of Santa Clara* (1951) 37 Cal.2d 333, 337-340 [affirming rule, but noting a trend outside California toward the abandonment of a conclusive presumption and the adoption of a rule that an enrolled bill is entitled only to a prima facie presumption of validity which may be attacked by extrinsic evidence].)

Having reviewed the relevant case law, the Court must agree with the Senate. Even if it is this Court's view that the Enrolled Bill Rule is due for re-examination, the Court is not aware of any published cases overruling the Rule or questioning its continuing validity. Thus, the Court is constrained to conclude that the Enrolled Bill Rule remains in full effect in California. It remains the rule in California that when an act of the Legislature is valid on its face, properly enrolled, authenticated and filed, it is conclusively presumed that all of the steps required for its passage have been properly taken, and even the journal of the Legislature is not available to impeach it.

This Rule is binding on this Court and, because the procedural defects alleged by Petitioner are not evident on the face of the legislation itself, dispositive of CalTax's article IV claims.

In any event, even if the Court were to admit extrinsic evidence for the purpose of showing the Legislature failed to comply with the constitutional requirements of article IV, the Court would find that the Legislature at least substantially complied with the "reading" requirement, and that CalTax has failed to make even a prima facie showing that the Legislature failed to comply with the "printing and distribution" requirement.

In a letter brief filed on May 12, 2009, CalTax argues that the substantial compliance doctrine is limited to election matters, but this argument lacks merit. First, the California Supreme Court expressly stated that the doctrine of substantial compliance may apply in regard to alleged violations of constitutional lawmaking requirements. (See *People ex rel. Levin, supra*, 37 Cal.2d at p.341.) Second, there are numerous examples of judicial acceptance of the doctrine outside the realm of election contests. The Court in *Hanf v. Sunnyview Development, Inc.* (1982) 128 Cal.App.3d 909, 916 lists many examples of situations where the doctrine of substantial compliance has been applied, including, without limitation, tort claim filing requirements, zoning laws, CEQA notice requirements, service requirements, the contents of a notice of appeal, and rules governing rejection of arbitration awards.

CalTax also argues that even if the doctrine of substantial compliance applies, the Legislature did not comply at all with the "rollcall" vote requirement. The Court finds that CalTax frames the issue too narrowly. The question is not whether the Legislature held a rollcall vote, but whether it substantially complied with the reading requirement by virtue of its non-rollcall vote. The Court

concludes that it did. Accordingly, even if the Enrolled Bill Rule is not a defense, the legislation at issue here substantially complied with the constitutional "reading" requirement and was validly enacted.

C. The Excessive Fines Clause

CalTax's claim that section 19138 violates the Excessive Fines Clause of the U.S. Constitution is denied.

CalTax bears a heavy burden in attempting to demonstrate that section 19138 is unconstitutional on its face.

A facial challenge to the constitutional validity of a statute considers only the text of the measure itself, not its application to the particular circumstances of an individual.

To support a determination of facial unconstitutionality, voiding the statute as a whole, a plaintiff cannot prevail by suggesting that in some future hypothetical situation constitutional problems may possibly arise as to the particular application of the statute. Rather, a plaintiff must demonstrate that the act's provisions "inevitably pose a present total and fatal conflict with applicable constitutional prohibitions," i.e., that the law is incapable of any valid application. (*Pac. Legal Found. v. Brown* (1981) 29 Cal.3d 168, 180-181.)

For purposes of the Eighth Amendment, a civil penalty is a fine. (*San Francisco v. Sainez* (2000) 77 Cal.App.4th 1302, 1327.) CalTax's burden is to show that the fine is, in all cases, excessive.

Under the Eighth Amendment, a fine is considered excessive if it is "grossly disproportional" to the gravity of the offense (*United States v. Bajakajian* (1998) 524 U.S. 321, 334.) The touchstone of the constitutional inquiry is proportionality, which is assessed by examining the nature of the "offense" and its relationship to the penalty imposed; the penalties imposed for like offenses; the defendant's culpability; and the defendant's ability to pay. (*People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2005) 37 Cal.4th 707, 731-730.)

This is a heavily fact intensive inquiry. Although the Court does not foreclose the possibility that section 19138 may be found to be unconstitutional as applied to a particular taxpayer, CalTax has not met its burden to show that section 19138 is unconstitutional on its face. Accordingly, CalTax's Eighth Amendment claim is denied.

D. Substantive Due Process

The Court also denies CalTax's claims that section 19138 violates the substantive due process guarantees of the Fourteenth Amendment.

CalTax contends that section 19138 violates substantive due process because it is vague and retroactive.

Due Process requires that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. (*Grayned v. City of Rockford* (1972) 408 U.S. 104, 109.)

In this case, however, it is clear what is prohibited: understatements of taxes in excess of \$1 million. Thus, the statute gives fair warning of the conduct it requires, even if, as CalTax contends, it is difficult to comply or deliberately encourages over-compliance.

Whether the penalty violates substantive due process because it is retroactive depends on whether a retroactive application is so "harsh and oppressive" as to transgress the constitutional limitations. (*United States v. Carlton* (1994) 512 U.S. 26, 31-32; *City of Modesto v. National Med., Inc.* (2005) 128 Cal.App.4th 518, 529-530.) If the retroactive application of the legislation is justified by a "rational legislative purpose," and the period of retroactivity is "modest," the legislation will comply with due process. (*Id.*)

Here, the Legislature had a rational legislative purpose to make the penalty retroactive to encourage taxpayers who filed returns in which they took "questionable positions" to come forward and amend their returns. (*See Licari v. Commissioner* (9th Cir. 1991) 946 F.2d 690, 693.)

While a period of retroactivity longer than the year preceding the legislative session normally would raise constitutional issues, in this case, the constitutional concerns are allayed by taxpayers' ability to file an amended return, which will be treated as the original return for purposes of determining the penalty.

Therefore, the Court does not find the retroactive application of the penalty to be so harsh and oppressive as to transgress the constitutional limitation of the substantive due process clause.

E. Procedural Due Process

CalTax has argued that section 19138 violates taxpayers' procedural due process rights because it affords no pre- or post-payment review, except on the grounds that the amount of the penalty was not properly computed by FTB. Section 19138, subdivision (e) provides, in relevant part that "[a] refund or credit for any amounts paid to satisfy a penalty imposed under this section may be

allowed only on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board."

In contrast, FTB argues that the restrictions imposed by section 19138, subdivision (e) were intended to apply only to administrative refund claims, and do not preclude taxpayers from contesting the validity of the penalty in an action in superior court. Accordingly, FTB contends, the California Franchise and Income Tax Law provides a constitutionally adequate post-deprivation remedy in the form of a refund suit in superior court. (Rev. & Tax. Code § 19382.)

The Court finds this to be a close question. On the one hand, there is nothing in the literal language of section 19138 to support FTB's interpretation that subdivision (e) is confined to administrative refund claims.

On the other hand, it is a fundamental rule of statutory construction that a statute under consideration by a court must be given such construction as will result in wise policy rather than mischief or absurdity, and reasonably achieve its object and purpose within the context of the legislative scheme. (See *Franklin v. Municipal Court* (1972) 26 Cal.App.3d 884, 896 [court must adopt interpretation that eliminates doubts as to constitutionality]; *Rn Review for Nurses v. Cal.* (1994) 23 Cal.App.4th 120, 123 [words of a statute will not be literally construed if this would cause an absurd result].) If possible, a statute must be construed to preserve its constitutionality. If a court is presented with two alternative interpretations, one of which would be constitutional and the other unconstitutional, the court must choose the interpretation which will uphold the validity of the statute. (*Assn. for Retarded Citizens v. Dept. of Developmental Servs.* (1985) 38 Cal.3d 384, 394; *Mahon v. County of San Mateo* (2006) 139 Cal.App.4th 812, 821.)

Applying this rule of statutory construction here means that if section 19138, subdivision (e) possibly can be construed as applying only to administrative refund claims, it must be construed in this manner. The reason for this is the Constitution requires the government provide a procedure which, at some point, affords the taxpayer a meaningful opportunity to contest the legality of a tax penalty. (*City of Modesto, supra*, 128 Cal.App.4th at p.529; *Batt v. City and County of San Francisco* (2007) 155 Cal.App.4th 65, 72; see also *McKesson Corp. v. Div. of Alcoholic Bevs. & Tobacco* (1990) 496 U.S. 18, 38-39, 51-52 [where taxpayers are required to pay first, federal Due Process requires the government to provide a "clear and certain" post-deprivation procedure to challenge the validity of the tax].) Whether a state chooses to provide pre-deprivation process (e.g., an injunction) or instead afford post-deprivation relief (e.g., a refund) is a matter left to the state's discretion. (*Batt, supra*, at p.73.) If section 19138, subdivision (e) were construed to preclude all pre- or post-payment review, except on the grounds that the amount of the penalty was not properly computed by FTB, the Court would have little difficulty in concluding that the statute is unconstitutional and unenforceable.

But the same is not true if subdivision (e) is limited to administrative claims. Therefore, if section 19138, subdivision (e) is susceptible of FTB's interpretation, it must be construed in that manner.

The Court is persuaded that section 19138 is reasonably susceptible of the interpretation urged by FTB that subdivision (e) was not intended to limit the applicability of Section 19382 or the grounds upon which a refund or credit may be allowed in an action under Section 19382. (*See Coleman v. Department of Personnel Administration* (1991) 52 Cal.3d 1102, 1123 [where constitutional weakness lies primarily in what statute has omitted, and not in its express terms, the statute may properly be invoked so long as due process requirements are met].) Thus, the Court concludes that section 19382 must be interpreted in the manner urged by FTB.

Having concluded that section 19138 can -- and must -- be construed in this manner, the Court finds it unnecessary to invalidate and/or reform the statute. Provided the statute is interpreted in this manner, the statute properly may be invoked because the California Franchise and Income Tax Law provides a constitutionally adequate post-deprivation remedy in the form of a refund action in which taxpayers may contest the validity of the tax penalty. Accordingly, CalTax's procedural due process claim is denied.

F. Commerce Clause

CalTax's Commerce Clause claim is denied. First, CalTax's challenge is more properly directed to Revenue and Taxation Code section 25101.15, than section 19138.

Second, even if the claim is construed as a challenge to section 19138, CalTax has failed to show that section 19138 facially discriminates against interstate commerce.

A statute that has only incidental effects on interstate commerce must be upheld unless the burden imposed on interstate commerce is "clearly excessive" in relation to the putative local benefits. (*Pacific Merchant Shipping Assn. v. Voss* (1995) 12 Cal.4th 503, 517.) This is a high burden and it has not been met in this case. (*See Container Corp. of America v. Franchise Tax Bd.* (1981) 117 Cal.App.3d 988, 995 [noting formula for allocation of taxable income of unitary enterprise has been held not to impermissibly burden interstate commerce].)

G. Equal Protection Clause

CalTax's Equal Protection claim is based on the same "discrimination" alleged in its Commerce Clause claim. CalTax argues that such discrimination renders the statute "wholly arbitrary." But CalTax has failed to show that the classification in

section 19138 between taxpayers required to be included in a combined report, and those that are not, is not rationally related to a legitimate governmental purpose (namely, applying the \$1 million threshold on a collective basis where multiple taxpayers are engaged in a single, unitary business). Accordingly, the Court denies the Equal Protection claim.

H. Conclusion

For the reasons discussed above, the petition for mandate, request for injunctive relief, and request for an award of attorneys' fees shall be DENIED. The Court shall enter declaratory judgment that section 19138, as construed herein, is constitutional and enforceable on its face. Counsel for FTB shall prepare a formal judgment for the Court's signature, consistent with this ruling.

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CERTIFICATE OF SERVICE BY MAILING
(C.C.P. Sec. 1013a(4))

I, the Clerk of the Superior Court of California, County of Sacramento, certify that I am not a party to this cause, and on the date shown below I served the foregoing RULING AFTER HEARING by depositing true copies thereof, enclosed in separate, sealed envelopes with the postage fully prepaid, in the United States Mail at Sacramento, California, each of which envelopes was addressed respectively to the persons and addresses shown below:

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I, the undersigned deputy clerk, declare under penalty of perjury that the foregoing is true and correct.

Dated: 5/21/09

Superior Court of California,
County of Sacramento

B/: L. YOUNG,
Deputy Clerk

