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California Court of Appeal Ruled Taxpayers in Tax Refund Cases Are Entitled to a Jury Trial

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Addressing an issue of first impression, the First District Court of Appeal of California, in *Franchise Tax Board v. Superior Court of San Francisco*,¹ held that a taxpayer has a right to a jury trial for actions permitted under Section 19382 of the California Revenue and Taxation Code (“RTC”). RTC Section 19382 authorizes a taxpayer to bring a refund action against the California Franchise Tax Board (“FTB”) for income and franchise taxes that the taxpayer has paid. The FTB petitioned for review to the California Supreme Court, and the petition was granted. However, as of this publication date, an opinion has not yet been rendered.

Facts

The facts of this case are simple and straightforward. In July 2006, Tom Gonzales, the real party in interest, filed a complaint seeking a refund of California personal income tax for 2000 and 2001 totaling more than \$15 million. The tax had been paid to the FTB by the estate of the deceased Thomas J. Gonzales II in 2004 in connection with a tax amnesty program. Gonzales alleged that the \$15 million tax was not due because the estate was entitled to deductions for substantial capital losses from investments in the year 2000. The FTB denied the refund, asserting that the losses arose from “abusive tax avoidance transactions,” and filed a cross-complaint seeking to recover from the estate a penalty of almost \$2.5 million. Gonzales requested a jury trial in a joint case management statement. The trial court denied the FTB’s motion to strike the request, and the FTB sought a writ of mandate from the Court of Appeal to compel the trial court to reject the request for a jury.

Discussion of Constitutional Rights and Common Law

The Court of Appeal started its analysis by setting forth the general principles governing the right to a jury trial in California. The court first looked at the Constitution of California, which in pertinent part provides that “[t]rial by jury is an inviolate right and shall be secured to

¹ 99 Cal. Rptr. 3d 73 (Cal. Appl. 1st Dist. 2009), *review granted and opinion superseded* (Dec. 2, 2009).

all.”² Relying on prior California Supreme Court cases, the court stated that the right to a jury trial under the constitutional provision is the right as it existed in 1850, when the Constitution of California was first adopted. Thus, if there was a right to trial by jury in a refund action at common law in 1850, taxpayers should have the right to a jury trial in modern tax refund cases under RTC Section 19382. The court stated further that as a general principle, at common law, if the action involved a legal claim, a jury trial would be granted. On the other hand, a cause of action dealing with an equitable claim generally did not entitle a claimant to a jury trial.

Classification of the Refund Claim

The court next determined that the “gist” of Gonzales’s tax refund action was a legal claim. To reach this conclusion, the court relied on a California Supreme Court case, *Northrop Aircraft v. California Employment Stabilization Commission*,³ which held that a suit for a refund of taxes is in the nature of a common-law action for money had and received. The action was legal, even though a plaintiff’s right to recover depended on equitable principles.

Upon concluding that the gist of Gonzales’s action was legal rather than equitable, the court went on to determine whether, as a purely historical question, the right to trial by jury existed for refund actions at common law in 1850. The court began by noting that at common law, an individual had no right of action against a sovereign, whether by jury or otherwise. However, taxpayers were able to assert claims for refunds by suing the tax collectors rather than the government. These suits were legal claims for money had and received, and a plaintiff had a right to a jury trial. Concluding that cases against tax collectors were the closest analogues to modern refund actions, the court ruled that a right to trial by jury exists for tax refund suits.

Evaluation of Sovereign Immunity

The court rejected the FTB’s argument that the sovereign immunity doctrine foreclosed any right to a jury trial regardless of any history of common-law refund actions against tax collectors. The FTB contended that suits against tax collectors are not equivalent to suits against the sovereign itself. Even though the FTB’s argument was supported by case law under the Seventh Amendment to the U.S. Constitution holding that there is no right to a jury trial in suits against the United States, the court ruled that a refund suit, even against a sovereign, was analogous to a common-law suit against a tax collector. Further, the court concluded that the California legislature provided for refund actions in RTC Section 19382, which constitutes the consent of the government to be sued according to the terms of the statute. In addition, the court found support in California Code of Civil Procedure Section 592, which provides that issues of fact must be tried by a jury in actions “for money claimed as due upon contract, or as damages for breach of contract, or for injuries.”⁴ The court concluded that a tax refund action is contractual in nature and is therefore covered under the statute.

² California Constitution, Article I, Section 16.

³ 32 Cal.2d 872 (1948).

⁴ California Code of Civil Procedure Section 592.

Refund Claim Distinguished from Tax Collection Claim

It is particularly worth noting that the court distinguished, at least in part, the present case from *Sonleitner v. Superior Court*,⁵ where the Second District Court of Appeal of California held that a taxpayer was not entitled to a jury trial in a tax collection case. *Sonleitner* dealt with the collection of motor vehicle license taxes, not a claim for refund. While acknowledging that in 1850 there was no common-law right to a jury trial in tax collection cases, the court refused to follow *Sonleitner*, holding that a refund claim is different from a tax collection claim.

Essentially, the court bifurcated Gonzales's refund claim from the FTB's cross-complaint seeking to collect the asserted underpayment penalty. Based on *Sonleitner*, the court held that Gonzales is not entitled to a jury trial for the FTB's cross-complaint seeking an underpayment penalty of almost \$2.5 million from Gonzales. The court determined that it is clear there was no common-law right to a jury trial in a proceeding to collect taxes, including tax penalties. Nevertheless, the bifurcation of the penalty collection claim may raise issues of collateral estoppel on the issue of whether the capital losses were properly deductible.

Implication for Taxpayers

This is the first case in California history adjudicating whether a taxpayer in a refund action is entitled to a jury trial in the California courts. While the case deals with California income tax, there is no policy reason to argue that the same rationale and conclusion should not be applicable to other state taxes, such as property tax or sales and use tax.

It is not clear what impact the decision, if left standing by the California Supreme Court, will have on tax litigation. In most cases, jurors are laypersons who do not have much tax background or experience. Many of them might be sympathetic, in various degrees, towards taxpayers and might be inclined to find facts in the taxpayer's favor. In addition, the higher costs of litigation would likely change the bargaining strategies of the government and taxpayers in settlement negotiations.

On the other hand, this case confirmed that a taxpayer in a tax collection case is not entitled to a jury trial. Therefore, the availability of a jury trial could be an important factor for taxpayers to consider in determining whether they want to pay the tax bills first and then seek a refund, or fight against the FTB without paying the asserted tax.



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⁵ 158 Cal.App.2d 258 (1958).