In the Supreme Court of the State of California

DICON FIBEROPTICS, INC.,

Plaintiff and Appellant,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Defendant and Respondent.

Case No. S173860

Court of Appeal, Second Appellate Dist. Div. Eight, Case No. B202997
Los Angeles County Superior Court, Case No. BC367885
The Honorable Mel Red Recana, Judge

OPENING BRIEF ON THE MERITS

EDMUND G. BROWN JR.
Attorney General of California
PAUL D. GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
W. DEAN FREEMAN
Supervising Deputy Attorney General
State Bar No. 73869
300 South Spring Street, Suite 1702
Los Angeles, CA 90013-1230
Telephone: (213) 897-2489
Facsimile: (213) 897-5775
Email: Dean.Freeman@doj.ca.gov

Attorneys for Defendant and Respondent Franchise Tax Board

TABLE OF CONTENTS

Page

ISSUE PRESENTED 1

INTRODUCTION 1

STATEMENT 3

ARGUMENT 8

I. A VOUCHER ISSUED BY AN ENTERPRISE ZONE IS NOT PRIMA FACIE EVIDENCE THAT A WORKER IS A "QUALIFIED EMPLOYEE" UNDER REVENUE AND TAXATION CODE SECTION 23622.7, AND IT DOES NOT SHIFT THE BURDEN OF PROOF TO THE BOARD 8

A. In Tax-Refund Actions, the Law Places the Burden of Proof on Taxpayers. 8

B. When Properly Construed, Section 23622.7 Does Not Provide That Vouchers Are Prima Facie Evidence That A Worker Is a "Qualified Employee" or Shift the Burden of Proof to the Board. 13

1. The Plain Language of Section 23622.7, Subdivision (c)(1) Supports the Board's Interpretation of That Section. 13

2. Even if the Language of Section 23622.7, Subdivision (c)(1) Is Ambiguous, the Rules of Statutory Construction Compel the Adoption of The Board's Interpretation of That Section. 15

a. Tax credit statutes are strictly construed. 15

b. Courts will not lightly presume that the Legislature intended to overturn longstanding principles of law. 19

TABLE OF CONTENTS
(continued)

Page

c. The Legislature knows how to bind the Board by the decision of another agency, to make a document prima facie evidence, or to shift the burden of proof..... 22

d. Legislative history supports the Board's interpretation. 25

C. The Decision Below Violates the Ban on Prepayment Tax Litigation in Article XIII, Section 32, and it Is Contrary to the Rule That a Tax-Refund Lawsuit Is a Trial De Novo in the Superior Court. 28

1. The Decision Below Violates Article XIII, Section 32 Because It Will Authorize Prepayment Tax Litigation. 29

2. The Decision Below Is Contrary to the Rule That A Tax-Refund Lawsuit Is a Trial De Novo in the Superior Court. 31

CONCLUSION. 34

TABLE OF AUTHORITIES

Page

CASES

Alpha Therapeutic Corp. v. Franchise Tax Bd.
(2000) 84 Cal.App.4th 1 ..... 16, 17, 19

Auerbach v. Assessment Appeals Bd. No. 2 for County of Los Angeles
(2008) 167 Cal.App.4th 1428 11

Butler Brothers v. McColgan
(1941) 17 Cal.2d 664 ..... passim

Collier & Wallis, Ltd. v. Astor
(1937) 9 Cal.2d 202 31

Cook v. United States
(2000) 46 Fed.Cl. 110 ..... 8, 21

County of Los Angeles v. Frisbie
(1942) 19 Cal.2d 634 ..... 21, 33

El Dorado Oil Works v. McColgan
(1950) 34 Cal.2d 731 9

Flannery v. Prentice
(2001) 26 Cal.4th 572 25

General Motors Corp. v. Franchise Tax Bd.
(2006) 39 Cal.4th 773 ..... passim

Great Western Financial Corp. v. Franchise Tax Bd.
(1971) 4 Cal.3d 1 ..... 15, 32

Honeywell, Inc. v. State Bd. of Equalization
(1982) 128 Cal.App.3d 739 9

Hospital Service of California v. City of Oakland
(1972) 25 Cal.App.3d 402 ..... 15, 16, 18, 19, 32

In the Matter of the Appeal of Deluxe Corp.
(Dec. 12, 2006, No. 297128) (2006-SBE-003) 5

Kavanaugh v. West Sonoma County Union High School Dist.
(2003) 29 Cal.4th 911 22

Krumpotich v. Franchise Tax Bd.
(1994) 26 Cal.App.4th 1667, rev. denied 9

Lennane v. Franchise Tax Bd.
(1994) 9 Cal.4th 263 ..... 13, 14, 32

Lewis v. Reynolds
(1932) 284 U.S. 281 ..... 8, 12, 21

Long Beach Fireman's Credit Union v. Franchise Tax Bd.
(1982) 128 Cal.App.3d 50 9

Microsoft Corporation v. Franchise Tax Bd.
(2006) 39 Cal.4th 750 12

Miller v. McColgan
(1941) 17 Cal.2d 432 ..... 15, 16, 18, 32

Morris v. Williams
(1967) 67 Cal.2d 733 9

Nast v. State Board of Equalization
(1996) 46 Cal.App.4th 343 ..... 31, 32

Pacific Fruit Express Co. v. McColgan
(1947) 67 Cal.App.2d 93 9

Pacific Gas & Electric Co. v. State Bd. of Equalization
(1980) 27 Cal.3d 277 30

Paine v. State Bd. of Equalization
(1982) 137 Cal.App.3d 438 10

People v. Murphy
(2001) 25 Cal.4th 136 22

People v. Schwartz
(1947) 31 Cal.2d 59 32

People v. Superior Court (Lavi)
(1993) 4 Cal.4th 1164 19

Silicon Valley Taxpayers Ass'n, Inc. v.
Santa Clara County Open Space Authority
(2008) 44 Cal.4th 431 11

State Bd. of Equalization v. Superior Court
(1985) 39 Cal.3d 633 ..... 29, 30

Theodor v. Superior Court
(1972) 8 Cal.3d. 77 ..... 20, 33

Todd v. McColgan
(1948) 89 Cal.App.2d 509 9

United States v. Janis
(1996) 428 U.S. 433 8

Western Oil and Gas Assn. v. State Bd. of Equalization
(1987) 44 Cal.3d 208 29

Woosley v. State of California
(1992) 3 Cal.4th 758 30

STATUTES

Cal. Code Regs., tit. 25
§ 8463, subd. (a)(1) 5
§ 8463, subd. (a)(7) 5

Gov. Code
§ 7070 ..... 3, 25
§ 7072, subd. (d) 3
§ 7073, subds. (a) and (b) 3
§ 7076, subds. (a)(1)(B) and (C) 4
§ 7076.1, subd. (b) 4

Int.Rev. Code
§ 41 20

Pen. Code
§ 1538.5 20

Rev. & Tax Code
§ 167 ..... 11, 24
§ 1841 23
§ 2634 23
§ 2862 23
§ 2927.5 23
§ 3004 23
§ 3364 23
§ 3374 23
§ 4376 23
§ 6714 23

Rev. & Tax Code (con't.)
§ 7058....23
§ 7730....23
§ 7865....23
§ 8256....23
§ 8973....23
§ 9257....23
§ 11474....23
§ 12681....23
§ 12834....23
§ 13681....23
§ 17053.8, subd.(c)(1)....25
§ 17299....23
§ 17299, subd. (b)....23
§ 19050....23
§ 19374....23
§ 19382....5
§ 19703....23
§ 19705(c)....23
§ 19720(b)....23
§ 19721(c)....23
§ 21027(b)....23
§ 23302(c)....24
§ 23305a....24
§ 23305d....24
§ 23305.1(d)....24
§ 23609....19, 20
§ 23622.7....passim
§ 23622.7, subd. (a)....3
§ 23622.7, subds. (b)(4)(A)(i)-(b)(4)A(iii)....1, 3
§ 23622.7, subd. (b)(4)(A)(iv)....2-4, 6, 18, 25
§ 23622.7, subd. (c)....4, 13, 26
§ 23622.7, subd. (c)(1)....4, 13-15, 18
§ 23622.7, subd. (c)(2)....2, 4
§ 23622.7, subds. (a), (c)(1), (c)(2)....1
§ 25128....12, 24
§ 25137....12, 24
§ 30213....24
§ 30303....24
§ 30456....24
§ 32456....24
§ 38514....24
§ 40191....24
§ 41118....24
§ 41144....24
§ 43402....24

Rev. & Tax Code (con't.)
§ 43504.....24
§ 45402.....24
§ 45854.....24
§ 46412.....24
§ 46605.....24
§ 50122.....24
§ 50155.....24
§ 55122.....24
§ 55304.....24
§ 60364.....24
§ 60423.....24
§ 60610.....24

CONSTITUTIONAL PROVISIONS

Cal. Const., art. XIII, § 32 .....passim

Cal. Const., art. XIII D, § 4(d) 11

OTHER AUTHORITIES

Assembly Committee on Revenue and Taxation,
Analysis of Sen. Bill No. 1770 (1993-1994 Reg. Sess.).....26

Evan Halper, *State Tax Breaks Benefits Companies, Not Workers*,
L.A. Times, Jan. 31, 2006, at 1, available at 2006 WLNR 6950200.....5, 27

Greater Avenues for Independence Act of 1985.....25

ISSUE PRESENTED

Revenue and Taxation Code section 23622.7 provides for a tax credit to employers that operate in depressed areas (called *enterprise zones*) and hire disadvantaged workers (called *qualified employees*). In addition to other requirements, an employer seeking to obtain the tax credit must obtain from one of several authorized entities, including the enterprise zone administrator, a *voucher* that certifies that its worker meets the statutory requirements to be a qualified employee. (Rev. & Tax. Code, § 23622.7, subds. (a), (c)(1), (c)(2).)

The issue presented is:

When an employer seeks a tax refund from the Franchise Tax Board for allegedly hiring a qualified employee under Revenue and Taxation Code section 23622.7, and the employer's only supporting documentation is a voucher issued by an enterprise zone agency, is the voucher prima facie evidence that a worker is a "qualified employee" that shifts the burden of proof to the Board?

INTRODUCTION

California provides favored tax treatment for certain expenditures in the form of tax credits. Dicon Fiberoptics, Inc. (Dicon) filed a claim for refund with the Franchise Tax Board (the Board) seeking over $3,000,000 in enterprise zone tax credits under Revenue and Taxation Code section 23622.7, which provides a tax credit for a portion of the wages paid by employers who operate in enterprise zones to their "qualified employees."

A "qualified employee" is one who works a required amount of time in an enterprise zone (§ 23622.7, subds. (b)(4)(A)(i)-(b)(4)(A)(iii)),[1] and who meets what is essentially a status test, which looks to whether the

[1] Statutory references are to the Revenue and Taxation Code unless otherwise noted.

employee is eligible for certain federal or state job training programs, or meets one of several other similar criteria (§ 23622.7, subd. (b)(4)(A)(iv)).

In order to qualify for the enterprise zone credit an employer must also obtain a certification (or *voucher*) from one of several entities, including the local enterprise zone administrator, stating that a particular worker is eligible under one of the status tests. (§ 23622.7, subd. (c)(2).) Part of Dicon's claimed tax credit (approximately $1,000,000) was based on employees for whom Dicon's only documentation of worker eligibility was a voucher issued by an enterprise zone administrator. The Board denied this portion of Dicon's claim.

Dicon then filed a tax-refund lawsuit in which it claimed that a voucher standing alone conclusively establishes that the subject worker is eligible. After the trial court granted the Board's demurrer without leave to amend, Dicon appealed. The Court of Appeal also rejected Dicon's argument, but nevertheless held that a voucher is prima facie evidence that shifts the burden to the Board to establish that the worker did not meet the eligibility requirements of section 23622.7, subdivision (b)(4)(A)(iv).

Under the lower court's interpretation of section 23622.7, in order to shift the burden to the Board, the employer is required merely to produce a voucher for the employee; indeed, according to the court below, the employer may discard all other supporting documentation that would establish the worker's eligibility. In fact, employers would be free even to discard documentation establishing that the worker was *ineligible*.

The appellate court's decision misinterprets section 23622.7 and imposes a rule that substantially increases the risk that tax credits will be allowed for employees that are in fact statutorily ineligible. A voucher is not prima facie evidence; rather, the voucher requirement and the voucher program are part of a process designed to conserve scarce Board resources by providing for an additional level of review that may in some cases, but

not necessarily all, relieve the Board of its need to audit, thus making the process more efficient for the Board, employees, and employers.

The court's decision is incorrect because: (1) it violates the general historical rule that the taxpayer has the burden of proof in tax-refund cases; (2) it is inconsistent with the plain language of the statute; (3) it violates other rules of statutory construction, particularly the rule that tax credit statutes must be strictly and narrowly construed against the taxpayer; (4) it is inconsistent with the legislative history; (5) it violates article XIII, section 32 of the California Constitution; and (5) it is contrary to the rule that tax-refund actions are trials de novo in the superior court.

STATEMENT

To encourage economic growth in areas that suffer from persistent unemployment, the Legislature enacted the Enterprise Zone Act, Government Code section 7070 et seq., which allows local governments to apply for and to obtain enterprise zone designation for economically depressed areas. (Gov. Code, §§ 7072, subd. (d), 7073, subds. (a) and (b).) Section 23622.7 provides a tax credit for enterprise zone businesses that hire eligible disadvantaged workers, or "qualified employees." The credit is between 10% and 50% of the wages of the employee, depending on the length of time he or she has been employed. (Rev. & Tax. Code, § 23622.7, subd. (a).)

Section 23622.7, subdivision (b)(4) defines a "qualified employee" as one who meets two separate types of statutory criteria. One generally limits the type and place of employment. (§ 23622.7, subds. (b)(4)(A)(i)-(b)(4)(A)(iii).) The other, which is essentially a status requirement, looks to whether the employee is eligible for certain federal or state job training programs, or is a dislocated worker, or meets one of various other similar criteria. (§ 23622.7, subd. (b)(4)(A)(iv).)

Section 23622.7, subdivision (c)(1) requires that an employer seeking to obtain the enterprise zone tax credit must obtain a certification from one of several entities, including the local enterprise zone administrator, stating that a particular employee is "qualified," that is, that the worker meets one of the statutory status tests under section 23622.7, subdivision (b)(4)(A)(iv)). (§ 23622.7, subd. (c)(1).)[2] These certifications are typically referred to as *vouchers* and must be retained by the employer and presented to the Board upon request. (§ 23622.7, subd. (c)(2).)

Dicon does business in an enterprise zone. (Slip op. at p. 4; AA at p. 17, lns. 9-12.)[3] In November 2003, it filed an amended tax return for its taxable year ending March 31, 2001—which is treated by law as a claim for refund pursuant to section 19322—in which it claimed over $3 million in enterprise zone tax credits. (AA at p. 15, lns. 9-12.) The Board audited Dicon's return and denied approximately $1 million of the $3 million claim. (AA at p. 19, lns. 5-6.) The Board denied the portion of the claim that was for those wages paid to employees for which the only documentation of worker eligibility Dicon provided was a voucher issued by an enterprise zone administrator. (AA at p. 18, lns. 7-21.)

Although enterprise zone administrators are established by statute, they often function more like a trade group or marketing organization whose primary function is to attract and accommodate enterprise zone employers. (See Gov. Code, §§ 7076, subds. (a)(1)(B) and (C), 7076.1,

---

[2] Effective August 16, 2004, and continuing thereafter, the provisions of section 23622.7, subdivision (c), were amended to change the entities authorized to issue vouchers. (Stats. 2004, c. 225 (S.B. 1097).)

[3] The designation "AA" refers to the Appellant's Appendix filed in the Court of Appeal. References thereto are indicated by "AA at p. [page], ln. [line]."

subd. (b).) And while there are significant statutory restrictions upon employee eligibility for the tax credit, at the time the vouchers were issued in this case there were *no* statutory or regulatory requirements regarding the documentation required to obtain or issue a voucher. In addition, there is no requirement for an agency that issues vouchers to communicate at all with the employees for whom it is requested to supply vouchers, and vouchers may be retroactively issued years after the employment takes place.

Nor, until new regulations that became effective November 27, 2006, was there even a requirement that enterprise zone agencies keep voucher records. (Cal. Code Regs., tit. 25, § 8463, subd. (a)(1).) However, although these new regulations in one section tightened the record keeping requirements, in another section they allowed zone administrators to delegate the issuance of vouchers to any other person or entity they chose. (Cal. Code Regs., tit. 25, § 8463, subd. (a)(7) [governing body of the zone "may designate a third party entity to process voucher applications"].)[4]

After Dicon's administrative claim was denied, it filed a tax-refund action against the Board in the superior court under section 19382. (AA at p. 3, lns. 21-23.) Dicon's suit alleged that the Board had wrongfully refused to accept its vouchers as conclusively establishing employee eligibility, but instead demanded evidence thereof. (AA at p. 18, lns. 7-9.)

---

[4] Reports of voucher irregularities, or worse, have been widely circulated. (Evan Halper, *State Tax Breaks Benefits Companies, Not Workers*, L.A. Times, Jan. 31, 2006, at 1, available at 2006 WLNR 6950200.) And an audit of the Oakland enterprise zone conducted by the former Technology, Trade and Commerce Agency concluded that the "vouchering agent maintained inadequate records that were insufficiently documented or missing, failed to independently verify supporting source documents, and erroneously issued vouchers to ineligible employees." (See *In the Matter of the Appeal of Deluxe Corp.* (Dec. 12, 2006, No. 297128) (2006-SBE-003 at pp. 6-7) 2006 Cal.Tax Lexis 432 (*Deluxe*).)

Dicon did not allege that its employees met the eligibility requirements of section 23622.7, subdivision (b)(4)(A)(iv); instead it claimed that the Board erred in the audit, by rejecting Dicon's vouchers and by "creat[ing] an additional administrative burden on the taxpayer . . . ." (AA at p. 18, ln. 22 – p. 19, ln. 4.) Under Dicon's interpretation of section 23622.7, enterprise zone vouchers conclusively establish eligibility, and the Board is barred from auditing or looking behind the vouchers and therefore from requiring evidence of worker eligibility.

The Board demurred. It argued, among other things, that taxpayers have the burden of proof in tax-refund suits "not only to demonstrate the Board's determination is incorrect, but also to allege facts from which a proper tax determination can be made . . . ." (AA at p. 36, lns. 15-18.) Since Dicon's complaint admitted that it had nothing other than its vouchers to establish that its workers were "qualified employees" under section 23622.7, the Board argued that Dicon could not as a matter of law establish its right to a refund and that the demurrer should therefore be granted without leave to amend. (AA at p. 37, lns. 10-17.) The Board also argued that nothing in section 23622.7 barred it from looking behind the vouchers and requiring employers to provide evidence that their workers met the statutory eligibility requirements. (AA at p. 37, ln. 18 – p. 38, ln. 7.) In addition, the Board argued that tax credit statutes must be strictly and narrowly construed against the taxpayer. (AA at p. 42, ln. 12 to p. 43, ln. 2.) The trial court sustained the Board's demurrer without leave to amend. (AA at pp. 240-241.)

Dicon appealed, again arguing that under section 23622.7 vouchers conclusively establish worker eligibility and are binding on the Board. (Slip op. at p. 7.) Shortly after oral argument, the Court of Appeal ordered the parties to submit letter briefs on the previously unraised issue of whether "the voucher [should] be prima facie evidence that the taxpayer

was entitled to receive the voucher, thus placing on the board the burden of proving that the voucher does not support the taxpayer receiving a tax credit." (See slip op. at p. 7, fn. 6.) The Board argued, among other things, that interpreting section 23622.7 in a way that would make vouchers prima facie evidence would impermissibly relieve the taxpayer of its historical burden of proof, was contrary to the plain language of the section, was contrary to other rules of statutory construction (primarily the long-standing rule that tax credit statutes are narrowly construed against the taxpayer), and was inconsistent with the relevant legislative history. The Board also argued that a rule establishing an evidentiary presumption and accompanying shift in the burden of proof at the audit stage violates the constitutional provision against prepayment tax litigation in article XIII, section 32 and is contrary to the rule that tax-refund actions are trials de novo in the superior court.

Although the Court of Appeal correctly rejected Dicon's interpretation of section 23622.7 that vouchers conclusively establish worker eligibility, it did hold that "vouchers are prima facie proof a worker is a 'qualified employee,' but [the Board] may audit such vouchers" and that "[i]n such an audit, [the Board] bears the burden of rebutting the voucher's prima facie value . . . ." (Slip op. at p. 7.) The court acknowledged that the Legislature understands how to designate something as prima facie evidence, and that it did not do so here, but the court dismissed this omission as "legislative oversight." (Slip op. at p. 11, fn. 9.) The court also held that an employer may discard all relevant documents other than the voucher, and no adverse inference arises when an employer does so. (*Id.* at p. 12, fn. 10.)

On August 19, 2009, this Court granted review.

ARGUMENT

I. A VOUCHER ISSUED BY AN ENTERPRISE ZONE IS NOT PRIMA FACIE EVIDENCE THAT A WORKER IS A "QUALIFIED EMPLOYEE" UNDER REVENUE AND TAXATION CODE SECTION 23622.7, AND IT DOES NOT SHIFT THE BURDEN OF PROOF TO THE BOARD

A. In Tax-Refund Actions, the Law Places the Burden of Proof on Taxpayers.

In tax litigation, the burden of proof has historically fallen on taxpayers. In *Lewis v. Reynolds* (1932) 284 U.S. 281, the Supreme Court of the United States explained that: "The action to recover on a claim for refund is in the nature of an action for money had and received, and it is incumbent upon the claimant to show that the United States has money which belongs to him." (*Id.* at p. 283.) In *United States v. Janis* (1996) 428 U.S. 433, the high court also noted that "[i]n a refund suit the taxpayer bears the burden of proving the amount he is entitled to recover." (*Id.* at p. 440.) In *Cook v. United States* (2000) 46 Fed.Cl. 110, the Court of Federal Claims noted that the rule may have had its "genesis as early as 1836, when the Supreme Court 'recognized the existence of a right of action against a Collector of Customs for a refund of duties illegally assessed and paid under protest.'" (*Id.* at p. 116, fn. 15; citation omitted.) It is clear that the rule has a firm foundation in federal law.

The same rule exists in California. In 1941, in a case where the Franchise Tax Commissioner utilized a formula to allocate the income and deductions of a multi-state corporation, this Court explained that "[t]o rebut the presumption that the formula produced a fair result, the burden is on the taxpayer to make oppression manifest by clear, cogent evidence." (*Butler Brothers v. McColgan* (1941) 17 Cal.2d 664, 677; internal quotation marks omitted.) In 1947, the Court of Appeal followed the lead of the United States Supreme Court's 1932 *Lewis v. Reynolds* case and held, in *Pacific*

Fruit Express Co. v. McColgan (1947) 67 Cal.App.2d 93, that the taxpayer may "recover only if it be shown that more taxes have been exacted than in equity and good conscience should have been paid." (*Id.* at p. 96.) In 1948, the Court of Appeal explained, in *Todd v. McColgan* (1948) 89 Cal.App.2d 509, that "[t]he taxpayer cannot merely assert the incorrectness of a determination of a tax or the method used and thereby shift the burden to the commissioner to justify the tax and the correctness thereof." (*Id.* at p. 514.) In 1950, in a case challenging the constitutionality of a tax statute, this Court adopted the rule and language of the *Pacific Fruit Express* case and held that "the burden is on the taxpayer to . . . [establish] by clear, cogent evidence that more taxes have been exacted than in equity and good conscience should have been paid." (*El Dorado Oil Works v. McColgan* (1950) 34 Cal.2d 731, 744, citations and internal quotation marks omitted; see also *Long Beach Fireman's Credit Union v. Franchise Tax Bd.* (1982) 128 Cal.App.3d 50, 55 ["the burden of proof was on the taxpayer to show that the tax assessment was in error and that money paid should have been refunded"]; and *Krumpotich v. Franchise Tax Bd.* (1994) 26 Cal.App.4th 1667, 1671, rev. denied [taxpayer claiming a deduction bears the ultimate burden of proving facts to justify the deduction].)

The purposes of the rule imposing the burden of proof upon the taxpayer are simple and supported by common sense. As this Court has explained, as a matter of policy the person having the power to create, maintain, and provide the evidence should carry the burden of proof. (*Morris v. Williams* (1967) 67 Cal.2d 733, 760.) The Court of Appeal similarly explained in *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, that the burden of proof is on the taxpayer rather than the tax agency or tax collector because it is the taxpayer who (1) creates the transaction which is the subject of the inquiry, (2) has the power to determine the nature of the transaction, (3) has the power to create and

retain detailed records or other evidence needed to prove its nature and proper tax treatment, and (4) has the power to destroy or conceal the records or other evidence which would establish the taxable nature of the transaction. (*Id.* at pp. 744-745.)

It is also a matter of fairness. In *Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, the Court of Appeal explained that "[f]airness dictates that those persons responsible for paying the tax should maintain sufficiently complete records that the Board or other tax collecting agencies can determine if the correct amount of taxes have been paid." (*Id.* at p. 444.)

The factors discussed above are particularly important in an enterprise zone credit case. The employer certainly has more knowledge of its own employees' eligibility than the Board does. In fact, of the three entities involved, the employer, the voucher provider, and the Board, the only one that has no knowledge of the facts or control of the evidence is the Board. As a matter of policy, it is appropriate to place the burden on the employer because it controls the evidence of its employees' eligibility and can suppress or destroy contrary evidence. It is also fair given the Board's lack of control over the evidence. Moreover, in light of the checkered history of enterprise zones' voucher programs, following the general rule makes even more sense.

In the decision below, however, the Court of Appeal stated that eligibility documents are not ordinarily within the employer's custody and control. (Slip op. at p. 12.) This is incorrect. Nothing requires a vouchering agency ever to receive any documents from, or even have any contact with, a prospective employee. In fact, the Board is concerned that in many cases, if not most, the only documents a vouchering agency receives are from the employer. And nothing bars an employer (or even an agent working for the employer on a contingency basis) from directly

contacting voucher agencies and obtaining vouchers years after the fact. The Board is also concerned that this practice is becoming increasingly common.[5]

The only exceptions to the general rule placing the burden of proof on the taxpayer are where the Legislature (or the electorate, in the case of an initiative) chose to shift the burden. For example, in lawsuits challenging property fees and assessments, article XIII D, section 4(d) of the California Constitution places the burden of proof on local government agencies. (*Silicon Valley Taxpayers Ass'n, Inc. v. Santa Clara County Open Space Authority* (2008) 44 Cal.4th 431, 445.) However, article XIII D, section 4(f) contains explicit language reversing the traditional burden of proof. It states that "[i]n any legal action contesting the validity of any assessment, the burden shall be on the agency . . . ." There is no similar language in section 23622.7.

Likewise, in an appeal of a property tax assessment on an owner-occupied single-family dwelling, or an escape (retroactive) assessment, section 167 shifts the burden to the assessor. (*Auerbach v. Assessment Appeals Bd. No. 2 for County of Los Angeles* (2008) 167 Cal.App.4th 1428, 1439.) Again, the burden-shifting language in section 167 is clear: the section is entitled "Rebuttable presumption affecting burden of proof," and states that "there shall be a rebuttable presumption affecting the burden of

---

[5] Given the problems in the voucher programs, the court's conclusion below that employers have "no duty to maintain the relevant documents" and are free to discard them (slip op. at p. 12, fn. 10) undercuts the historical rule regarding the burden of proof and its underlying policy that fairness requires that those responsible for paying the tax should maintain sufficiently complete records so that tax agencies can determine if the correct amount of taxes have been paid. If the records are so deficient that a proper audit cannot be made, the defaulting record-keeping taxpayer should bear the consequences.

proof in favor of the taxpayer . . . ." Once, again, section 23622.7 contains no similar language.

In a slightly different situation, this Court held that the party invoking section 25137 has the burden of proof, whether the taxpayer or the Board. (*Microsoft Corporation v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 765 [*Microsoft*].) Section 25137 provides an exception to section 25128's statutory three-factor formula—payroll, property, and sales—for allocating or apportioning the income of multi-state and multi-national unitary businesses to California in cases where the statutory formula "do[es] not fairly represent the extent of the taxpayer's business activity in this state . . . ." (§ 25137.) In such cases, "the taxpayer may petition for or the Franchise Tax Board may require" another method. (*Ibid.*) Whichever party uses this exception to the general statutory rule has the burden of proving that its method is reasonable. (*Microsoft*, *supra*, 39 Cal.4th at p. 765.) Here, too, the burden-shifting is obvious from the language of the statute and from its function as an exception to the general rule, which is equally available to both parties.

The general rule imposing the burden of proof on taxpayers in tax-refund cases is of long-standing duration. It was established by the Supreme Court of the United States in 1932 in *Lewis v. Reynolds*, and in 1941 by this Court in *Butler Brothers v. McColgan*. The rule is based on sound policy and has been followed since. And unlike the present case, the only exceptions to the rule are where lawmakers explicitly shifted the burden of proof. Furthermore, the rationale behind the rule is particularly important here because inadequate review by voucher programs (whether intentional or otherwise) may leave the employer as the sole possessor of the relevant records. Since the employer has the power to create, maintain, or even destroy these records, it is only fair that it also carry the burden of proof.

We now turn to the statute at issue.

B. When Properly Construed, Section 23622.7 Does Not Provide That Vouchers Are Prima Facie Evidence That A Worker Is a "Qualified Employee" or Shift the Burden of Proof to the Board.

1. The Plain Language of Section 23622.7, Subdivision (c)(1) Supports the Board's Interpretation of That Section.

Section 23622.7, subdivision (c) does not make vouchers prima facie evidence of worker eligibility or shift the burden of proof to the Board. This Court has explained the principles of statutory construction:

> The applicable principles of statutory construction are well settled. "In construing statutes, we must determine and effectuate legislative intent." (*Woods v. Young* (1991) 53 Cal.3d 315, 323 [279 Cal.Rptr. 613, 807 P.2d 455].) "To ascertain intent, we look first to the words of the statutes" (*ibid.*), "giving them their usual and ordinary meaning" (*DaFonte v. Up-Right, Inc.* (1992) 2 Cal.4th 593, 601 [7 Cal.Rptr.2d 238, 828 P.2d 140]). If there is no ambiguity in the language of the statute, "then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs." (*Kizer v. Hanna* (1989) 48 Cal.3d 1, 8 [255 Cal.Rptr. 412, 767 P.2d 679].) "Where the statute is clear, courts will not 'interpret away clear language in favor of an ambiguity that does not exist.' [Citation.]" (*Hartford Fire Ins. Co. v. Macri* (1992) 4 Cal.4th 318, 326 [14 Cal.Rptr.2d 813, 842 P.2d 112].)

(*Lennane v. Franchise Tax Bd.* (1994) 9 Cal.4th 263, 268 (*Lennane*).)

The Board submits that this is a case where the language of the statute is clear. The text of section 23622.7 is important both for what it says and what it does not say. It does not say anything at all about the

burden of proof or prima facie evidence, but section 23622.7, subdivision (c)(1) does specifically require that an employer must obtain a certification from a voucher provider.

Section 23622.7's silence with regard to the burden of proof or prima facie evidence is to be expected because the law establishing that taxpayers have the burden of proof in tax-refund actions is, as shown above (section A), well established. Tax statutes granting exemptions, deductions, or credits typically do not make even a passing reference to the burden of proof. One would not expect to see a tax deduction statute state that the burden of proof is on the taxpayer because the general rule already establishes that. For the same reason, the silence of section 23622.7 regarding evidentiary presumptions or the burden of proof does not create an ambiguity because the existence of the general rule dictates that such silence is the norm.

However, the Court of Appeal found it significant that section 23622.7, subdivision (c)(1) requires an employer to obtain a voucher. The court apparently believed that "[the] employer's compliance with the statute ought to count for something." (Slip op. at p. 12.) And so it should; it just does not "count for something" in the way the appellate court thinks. The Board's position is that the voucher requirement in section 23622.7, subdivision (c)(1) is nothing more or less than what it plainly states, which is that a taxpayer must obtain a voucher. Thus, compliance with the voucher requirement does "count for something," it satisfies the terms of the statute that the Legislature enacted. Doing so is necessary, but not sufficient, to qualify for the tax credit.

"If there is no ambiguity in the language of the statute, then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs." (*Lennane*, *supra*, 9 Cal.4th at p 268; citations and internal quotations omitted.) In this case, there is no ambiguity in

section 23622.7. The statute simply requires a voucher as a condition of obtaining the tax credit.

2. Even if the Language of Section 23622.7, Subdivision (c)(1) Is Ambiguous, the Rules of Statutory Construction Compel the Adoption of The Board's Interpretation of That Section.

Even if this Court finds that the text of section 23622.7 is ambiguous, other rules of statutory construction fully support the Board's interpretation.

a. Tax credit statutes are strictly construed.

Income tax credits are a matter of legislative grace and are strictly and narrowly construed against the taxpayer. In *Miller v. McColgan* (1941) 17 Cal.2d 432, this Court held that a "provision allowing a credit . . . is in effect an exemption from liability for a tax already determined and admittedly valid, and such statute must be strictly construed against the taxpayer . . . ." (*Id.* at pp. 441-442; *Great Western Financial Corp. v. Franchise Tax Bd.* (1971) 4 Cal.3d 1, 5 ["[d]eductions may be allowed or withheld by the Legislature as it sees fit . . . and such deductions, like credits and exemptions, are to be narrowly construed against the taxpayer . . . ."].) In construing a tax credit statute, all doubts must be resolved in favor of the Board.

This Court explained, in *General Motors Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 773, 790 (*General Motors*), that "[w]e construe . . . the research tax credit . . . strictly against [the taxpayer], resolving any doubts in favor of the Board." (*Id.* at p. 790.) If the taxing authority's "interpretation . . . is reasonable it must . . . be adopted. It is of no moment that the statute may be ambiguous, or that a contrary construction might also be reasonably permissible." (*Hospital Service of California v. City of*

Oakland (1972) 25 Cal.App.3d 402, 406 (*Hospital Service*).) "The taxpayer has the burden of showing that he clearly comes within the exemption." (*Alpha Therapeutic Corp. v. Franchise Tax Bd.* (2000) 84 Cal.App.4th 1, 6 [*Alpha Therapeutic*]; citations omitted.)

The appellate court's decision that vouchers are prima facie evidence which shifts the burden of proof to the Board violates each of these rules. The decision fails to construe section 23622.7 strictly against the taxpayer and to resolve all doubts in favor of the Board as required by *Miller v. McColgan* and *General Motors*. As the Board explained below, the Legislature knows how to make a document prima facie evidence and has done so more than fifty times in the Revenue and Taxation Code. The court, however, held that the "most likely explanation" of the Legislature's failure to do so in this instance was merely "legislative oversight." (Slip op. at p. 11, fn. 9.) Of course, because the court's "most likely explanation" supported the taxpayer's interpretation, the decision below violates the rules set forth by this Court in *Miller v. McColgan* that a tax credit "statute must be strictly construed against the taxpayer" (17 Cal.2d at pp. 441-442) and in *General Motors* "resolving all doubts in favor of the Board" (39 Cal.4th at p. 790).

The court's decision also violates the rule that the tax authority's interpretation of a tax credit statute must be adopted if it is reasonable, regardless of whether the statute is ambiguous or susceptible of another reasonable interpretation. (*Hospital Service*, *supra*, 25 Cal.App.3d at p. 406.) It is reasonable to conclude, as the Board has, that this statute did not silently shift the burden or proof, given the general rule that taxpayers have the burden of proof in tax-refund cases. It is reasonable to conclude that, as will be discussed in more detail below, if the Legislature wanted to impose the burden of proof on the Board it would not have done so implicitly, rather it would have used clear language. And it is reasonable to assume, as

will also be discussed in more detail below, that, given the Legislature's expression of concern about potential tax abuse in regard to vouchers and enterprise zone credits, it would have imposed the voucher requirement on taxpayers while preserving both the Board's discretion to audit and the traditional burden of proof.

It is also reasonable to conclude that vouchers provide for an additional level of review which may satisfy the Board in some cases, while not in others. For example, in some cases the Board's review of a statistically significant sample of an employer's vouchers may convince it that the vouchers were properly issued only for eligible workers. In this case the Board may accept the vouchers without demanding the production of specific documentation of worker eligibility, or without any additional investigation. In other cases, though, the review of the employer's vouchers may raise concerns with the Board, or even reveal that vouchers were improperly issued. In these cases the Board will prudently demand evidence or documentation of worker eligibility. The Board is not required to audit every voucher in every case, just as it is not required to audit every taxpayer's return; in fact, the Board's limited budget effectively prevents this as a practical matter. In fact, given budgetary constraints, one would expect that the Board's review of employee eligibility would probably occur only in those cases where it has information that vouchers may have been improperly issued. But it is reasonable to believe that the Legislature certainly intended to preserve the Board's discretion to do so when warranted and to preserve the historical rule that taxpayers bear the burden of proof in tax-refund lawsuits.

The court's decision also relieves a taxpayer of "the burden of showing that he clearly comes within the exemption." (*Alpha Therapeutic*, *supra*, 84 Cal.App.4th at p. 6.) Section 23622.7, subdivision (a) provides the tax credit to an employer who "employs a qualified employee."

Section 23622.7, subdivision (b)(4) defines a "qualified employee" as one who meets several requirements, including a status requirement under subdivision (b)(4)(A)(IV). Because section 23622.7, subdivision (c)(1) does not explicitly shift the burden of proof or state that vouchers are prima facie evidence, a taxpayer who relies upon vouchers alone to establish the entitlement to the enterprise zone tax credit has failed to establish that its workers are qualified under subdivision (b)(4)(A)(IV) and has accordingly failed to meet its "burden of showing that [it] clearly comes within the exemption." (*Ibid.*)

In addition, given the court's acknowledgement that the Legislature had not "directed its attention to the matter" (Slip op. at p. 11, fn. 9), the decision below is even more troublesome. The court explained: "If, however, we have incorrectly deduced what the Legislature would have enacted if it had directed its attention to the matter, the Legislature is free to correct us by amending the statute to make its intention clear." (Slip op. at p. 11, fn. 9.) Again, however, this is contrary to the settled rules that tax "credit statute[s] must be strictly construed against the taxpayer," (*Miller v. McColgan*, *supra*, 17 Cal.2d at p. 442), and that if the Board's "interpretation . . . is reasonable it must . . . be adopted" (*Hospital Service*, *supra*, 25 Cal.App.3d at p. 406). The decision is also problematic because it will encourage courts in the future to resolve ambiguities in favor of the taxpayer, to reject the Board's interpretation of a tax-credit statute even if it is reasonable, and then to rely on the Legislature to make any corrections. As this Court explained in *General Motors* when considering the research tax credit, "[o]ur role is confined to ascertaining what the Legislature has *actually* done, not assaying whether sound policy might support a different rule." (*Ibid.*; emphasis added.)

In short, the decision below is contrary to the law. It does not construe section 23622.7 strictly against the taxpayer, as required by *Miller*

v. McColgan, nor does it resolve all doubts in favor of the Board as required by *General Motors*. It also violates the rule in *Hospital Services* that the Board's interpretation of a tax credit statute must be adopted if it is reasonable, regardless of whether the statute is ambiguous, and it has relieved Dicon of its burden under *Alpha Therapeutic* to show that it clearly comes within the exemption. And finally, the court's acknowledgement that the Legislature had not "directed its attention to the matter" (Slip op. at p. 11, fn. 9) will only encourage other courts to resolve ambiguities in favor of the taxpayer, to reject tax agencies' reasonable interpretations, and then to rely on the Legislature for corrections.

b. Courts will not lightly presume that the Legislature intended to overturn longstanding principles of law.

Courts should not presume that the Legislature, in enacting statutes, intends to overturn long-established rules or principles of law unless that intention is clearly made. The point is illustrated in *General Motors*, *supra*, in which this Court held that a corporate taxpayer group could not apportion its research tax credit among group members that did not actually incur research expenses even though the statute was silent on the point, primarily because there was an established federal rule denying such treatment.[6]

Section 23609 provides a research tax credit in "an amount determined in accordance with Section 41 of the Internal Revenue Code...." General Motors argued that other members of its corporate group should be able to share the research tax credit, even though section 23609 was silent

---

[6] This point is also consistent with the rule that the Legislature is presumed to be aware of existing case law. (*People v. Superior Court (Lavi)* (1993) 4 Cal.4th 1164, 1178-1179, fn. 9.)

on the issue. This Court explained that Internal Revenue Code section 41 (IRC section 41), which specifies the types of research, expenses, and calculations used to determine the credit, "provides insight into the question." (*General Motors*, *supra*, 39 Cal.4th at p. 791.) Although federal corporate tax law does not look to principles of apportionment that apply under California law, the Court nevertheless found that IRC section 41 and its regulations established a rule disallowing the allocation of research credits to members of the corporate group that did not actually incur the requisite research expenses.

The Court concluded that section 23609's silence on the subject of allocation was not an indication that the Legislature intended to depart from IRC section 41's general rule disallowing allocations. The Court explained that:

> The Legislature could have noted its decision to depart from this rule when it passed section 23609 . . . . Yet nowhere in the statute does the Legislature indicate it wished to apply a different rule and issue credits based on apportioned, rather than actual, contributions to research. In the absence of a contrary statement, we must interpret section 23609 consistently with IRC section 41.

(*General Motors*, *supra*, 39 Cal.4th at p. 791.) The same situation exists here. The Legislature could have explained that it intended to depart from the existing rule that places the burden of proof on taxpayers, but it did not.

Similarly, in *Theodor v. Superior Court* (1972) 8 Cal.3d. 77, 90-92 (*Theodor*), the defendant claimed he could challenge the facts contained in an affidavit in support of a search warrant under Penal Code section 1538.5 (section 1538.5) even though the statute was silent on that point. In large part because there was an established rule prior to the enactment of section 1538.5 that permitted such a challenge, this Court agreed. As here, the question in *Theodor* was whether the Legislature intended "by its silence to

abrogate [an] established rule . . . ." (8 Cal.3d. at p. 92.) The Court explained that "it should not be presumed that the Legislature in the enactment of statutes intends to overthrow long-established principles of law unless such intention is made clearly to appear either by express declaration or by necessary implication." (*Id.* at p. 92, citations and internal quotation marks omitted.)

And in *County of Los Angeles v. Frisbie* (1942) 19 Cal.2d 634, this Court explained that "it is not to be presumed that the legislature in the enactment of statutes intends to overthrow long-established principles of law unless such intention is made clearly to appear either by express declaration or by necessary implication." (19 Cal.2d at p. 644.) Section 23622.7 does not indicate an express intent to abandon the long-established principle that places the burden of proof on taxpayers; nor, is it necessarily implied.

The principle that taxpayers bear the burden of proof in tax refund cases is well established. As explained above, the Supreme Court of the United States recognized the rule in 1932 in *Lewis v. Reynolds*, *supra*, 284 U.S. 281, and the Court of Federal Claims has explained that the rule may have had its "genesis as early as 1836 . . . ." (*Cook v. United States*, *supra*, 46 Fed.Cl. at p. 116, fn. 15.) In California, this Court recognized the rule in 1941 in *Butler Brothers v. McColgan*, *supra*, 17 Cal.2d at p. 677, and has followed it ever since. The principle that the taxpayer has the burden of proof is a foundational element of tax-refund litigation, and it is virtually unthinkable that the Legislature would have intended to silently overturn that rule in section 23622.7. To use this Court's words in *General Motors*, "nowhere in the statute does the Legislature indicate it wished to apply a different rule and [shift the historical burden of proof]. In the absence of a contrary statement, we must interpret section [23622.7] consistently with [the time-honored rule]." (*General Motors*, *supra*, 39 Cal.4th at p. 791.) If

the Legislature intended to make such a drastic departure from this well-settled law, it would not have done so by omission; it would have plainly stated its intent to make such a change.

c. The Legislature knows how to bind the Board by the decision of another agency, to make a document prima facie evidence, or to shift the burden of proof.

In interpreting whether the Legislature has intended by its silence to accomplish a particular result, courts also look to see whether the Legislature has in the past accomplished that result by using language that clearly expresses the requisite intent. Where the Legislature has shown it knows how to use specific language to achieve a particular result, but has chosen not to use that language in a particular case, it suggests that the silence is intentional and that the Legislature did not intend the result. In a case dealing with whether members of the same corporate group could share a research tax credit that was silent on the issue this Court observed, "We note . . . that when the Legislature wishes to allow corporations that have not incurred expenses to share in a tax credit, it knows how to say so." (*General Motors*, *supra*, 39 Cal.4th at p 791; *People v. Murphy* (2001) 25 Cal.4th 136, 159 ["the Legislature has shown that when it wants a sentence calculated without consideration of some circumstance, it knows how to use language clearly expressing that intent"]; *Kavanaugh v. West Sonoma County Union High School Dist.* (2003) 29 Cal.4th 911, 919 ["we find the Legislature knows how to specify the first day of paid service when it desires to designate that day as having legal consequences."].) This principle is important here because the Legislature has used explicit language on prior occasions to specifically accomplish what the Court of Appeal has concluded was its silent intent on this occasion.

In former section 17299 (now section 17274), which was enacted in 1974, the Legislature explicitly made the Board's treatment of a tax deduction dependent upon findings by another agency, yet it did not do so here. Section 17299 denies otherwise valid tax deductions for rental property that has been determined by a state or local regulatory agency to be "substandard." Substandard housing is defined as housing that has "been determined by a state or local government regulatory agency to violate state law or local codes dealing with health, safety, or building," and which after notice by the regulatory authority has not been brought into compliance in a timely period. (§ 17299, subd. (b).) Although the Legislature knows how to make tax treatment explicitly dependent upon findings by other agencies or entities, it chose not to in section 23622.7.

The Legislature also knows how to explicitly make a document prima facie evidence. The Revenue and Taxation Code contains more than fifty statutes that explicitly make a particular document prima facie evidence.[7] Although most deal with tax agency assessments or liens, they

---

[7] Rev. & Tax Code, § 1841 (notice of property tax assessment), § 2634 (certificate of delinquent roll), § 2862 (secured roll showing outstanding property taxes), § 2927.5 (delinquent roll, abstract list, or tax collector's certification), § 3004 (roll of assessment), § 3364 (affidavit for facts recorded), § 3374 (publication and affidavit for facts recorded), § 4376 (tax collector's certificate of outstanding taxes), § 6714 (certificate of delinquency), § 7058 (certificate for service), § 7730 (Controller's certificate of delinquency), § 7865 (certificate of outstanding taxes), § 8256 (certificate of service), § 8973 (certificate of delinquency), § 9257 (certificate of service), § 11474 (certificate of delinquency), § 12681 (certificate of delinquency), § 12834 (county recorder's certified lists), § 13681 (certificate of amount due), § 19050 (certificate of mailing), § 19374 (certificate of delinquency), § 19703 (certificate of non-filing), § 19705, subd. (c) (name appearing as a signature); § 19720, subd. (b) (name endorsement of refund warrant), § 19721, subd. (c) (signature is endorsement by the signatory), § 21027, subd. (b) (references to United States mail treated as including references to any designated delivery

(continued...)

clearly show that the Legislature knows how to make a document prima facie evidence by explicit language when it so chooses, yet it chose not to in section 23622.7.

Finally, the Legislature knows how to shift the burden of proof in a tax statute. As explained above (section A), both sections 167 and 25137 shift the burden of proof. In section 167, the burden is shifted to the assessor in an appeal of a property tax assessment and section 25137 shifts the burden to whichever party attempts to use the exception to section 25128's statutory three-factor formula for apportioning the income of multi-state and multi-national unitary businesses in California. But even though the Legislature knows how to shift the burden of proof, it chose not to in section 23622.7

Because existing statutes clearly establish that the Legislature knows how to make tax treatment dependent upon findings by other agencies or

---

(...continued)
service), § 23302, subd. (c) (Secretary of State's certificate of suspension or forfeiture), § 23305a (certificate of revivor for corporate name reinstatement), § 23305d (certificate of suspension or forfeiture), § 23305.1, subd. (d) (certificate of relief from voidability), § 30213 (certificate of jeopardy determination), § 30303 (certificate of delinquency), § 30456 (certificate of notice), § 30456 (certificate of delinquency for tax levy), § 32456 (certificate of notice), § 38514 (certificate of delinquency), § 40144 (certificate of delinquency determination), § 40191 (certificate of notice), § 41118 (certificate of delinquency determination), § 41144 (certificate of notice), § 43402 (certificate of compliance), § 43504 (certificate of notice), § 45402 (certificate of deficiency), § 45854 (certificate of notice), § 46412 (certificate of delinquency determination), § 46605 (certificate of notice), § 50122 (certificate of delinquency), § 50155 (certificate of notice), § 55122 (certificate of delinquency), § 55304 (certificate of notice), § 60364 (certificate of jeopardy determination), § 60423 (certificate of delinquency), and § 60610 (certificate of notice).

entities, to make a document prima facie evidence, or to shift the burden of proof, it is extremely unlikely that the Legislature intended to do any of those things in section 23622.7 without plainly stating such. Neither Dicon nor the court below have cited one tax statute where the Legislature did any of these things without including an explicit statutory directive. Yet the court below attributed the Legislature's silence to "legislative oversight." (Slip op. at p. 11, fn. 9.) The court erred.

d. Legislative history supports the Board's interpretation.

In situations where a statute is ambiguous, "in order to ascertain the most reasonable interpretation . . . the court may examine extrinsic information, including the statute's legislative history and underlying purposes." (*Flannery v. Prentice* (2001) 26 Cal.4th 572, 579.) The legislative history in this case shows that the Legislature was concerned with the potential for tax abuse in regard to enterprise zone credits. The Legislature first established enterprise zones in 1984 along with the predecessor enterprise zone tax credit. (See § 23622.7; Enterprise Zone Act, Gov. Code, § 7070, Stats. 1984, ch. 45, § 1.) Prior to 1994, the credit was based on qualified wages paid to a "qualified disadvantaged individual," which included those actually receiving services under the federal Job Training Partnership Act or registered in the Greater Avenues for Independence Act of 1985. (See also former § 17053.8, subd.(c)(1).)

In 1994, the tax credit was expanded to include those eligible to participate in those and other programs, or those who met other "status" requirements. (§ 23622.7, subd. (b)(4)(A)(iv).) The tax credit voucher first appeared as a statutory requirement at the same time. (§ 23622.7, subd. (c) (Stats. 1994, ch. 755).) Thus, the voucher program was *imposed* at the same time the Legislature expanded the base of qualified employees. (AA

at p. 202 [Assembly Committee on Revenue and Taxation, Analysis of Sen. Bill No. 1770 (1993-1994 Reg. Sess.) as amended on Jun. 2, 1994 ["As currently drafted, no documentation of eligibility would be required, opening the door for potential abuse of the credit."].) The Legislature's concern over the potential abuse of enterprise zone credits is addressed by preserving the traditional burden of proof, not by making vouchers prima facie evidence of employee eligibility.

The court below claimed that making vouchers prima facie proof was necessary to promote the purpose of the tax credit. (Slip op. at p. 12.) However, this is incorrect. As noted above, nothing bars an employer from obtaining its vouchers a substantial period of time after the close of the tax year at issue. Searching through personnel records in an effort to find eligible employees years after they were hired does nothing to promote enterprise zone employment.

The lower court also relied upon statements that the Board's staff made to the Legislature that the "vouchering process serves numerous functions for all parties" and that enterprise zone agencies "ought to shoulder the laboring oar in issuing vouchers." (Slip op. at pp. 12, 13.) These statements are consistent with the Board's interpretation of section 23622.7 that vouchers provide for an additional level of review which may satisfy the Board in some cases, but not in others. Despite the facts that some vouchers may be improperly issued and some employers will be required to provide documentation of worker eligibility, the program itself is still valuable because it has the potential in the right circumstances to conserve scarce Board resources and to generate efficiencies for both applicant employees and employers.

The most likely explanation for the voucher requirement in section 23622.7 is that the Legislature understood that enterprise zone credits carried a significant potential for abuse and imposed the voucher

requirement to help the Board by imposing an additional level of review. While in some instances this additional layer of review may be sufficient, in others it may not. But regardless, if put to the test by the Board, employers must not only establish that they met the threshold requirement by obtaining a voucher, they must also independently and affirmatively establish the other requirements of section 23622.7, including that each of their workers was a *qualified employee*.[8]

C. The Decision Below Violates the Ban on Prepayment Tax Litigation in Article XIII, Section 32, and it Is Contrary to the Rule That a Tax-Refund Lawsuit Is a Trial De Novo in the Superior Court.

Not only did the Court of Appeal hold that vouchers issued by an enterprise zone administrator are prima facie proof a worker is a qualified employee, it also held that the vouchers' status as prima facie evidence and the corresponding shift in the burden of proof apply at the *audit stage*. (Slip op. at p. 7.) The Board does not believe that section 23622.7 makes vouchers prima facie evidence at any point in either the administrative or legal process, but applying the presumption at the audit stage—rather than during a tax-refund lawsuit—is even more troublesome and has unintended implications for the Board and for tax litigation in general.

First, article XIII, section 32 of the California Constitution bars lawsuits seeking to enjoin the assessment or collection of a tax before the

---

[8] And it turns out that the Legislature was wise to be concerned. As the Los Angeles Times reported: "Loopholes, lax oversight and alleged cheating have allowed companies to profit from the state's enterprise zone program, in some cases shaving millions off their tax bills without meeting requirements." (Evan Halper, *State Tax Breaks Benefits Companies, Not Workers*, L.A. Times, Jan. 31, 2006, at 1, available at 2006 WLNR 6950200.) The Times also noted that officials "are auditing hundreds of companies that they suspect have received dubious credits totaling $100 million." (*Ibid.*)

tax is paid. Although the audit in this case followed Dicon's payment of taxes, the lower court's decision does not distinguish audits that precede payment from those that follow payment. While this case may not technically implicate article XIII, section 32 because the taxes were paid, the Board is concerned that as a practical matter the lower court's failure to distinguish post-payment audits from prepayment audits virtually guarantees that taxpayers who are undergoing an audit, but who have not yet paid their taxes, will refuse to comply with the Board's demands for non-voucher evidence of employee eligibility under section 23622.7, and will bring legal actions to enjoin the Board. The Legislature, however, has no power to authorize such taxpayer actions because they would violate article XIII, section 32.

Second, article XIII, section 32 also establishes that the only procedure available in California to challenge the validity of a tax is a post-payment tax-refund action. A post-payment tax-refund action is a trial de novo in the superior court, it is not a challenge to the Board's administrative findings, determinations, or assessments. Though the audit in this case occurred after the taxes were paid, the lower court's decision ignores the trial de novo requirement and impliedly (and erroneously) authorizes actions that challenge the Board's administrative decisions. While the Legislature may have the power to change the trial de novo rule, it did not do so in section 23622.7, which is completely silent on the subject.

1. The Decision Below Violates Article XIII, Section 32 Because It Will Authorize Prepayment Tax Litigation.

The bedrock of California tax litigation is article XIII, section 32 of the California Constitution. Although the Legislature has the power to fine-tune the rules regarding tax-refund lawsuits, the scope of its powers are

dependent on, and limited by, the terms of the state Constitution. Article XIII, section 32 provides:

> No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

(Cal. Const., art. XIII, § 32.)

The first sentence of article XIII, section 32 bars injunctions against the collection of state taxes, while the second sentence "provides that an action to recover an allegedly excessive tax bill may be brought '[after] payment of [that] tax . . . .'" (*State Bd. of Equalization v. Superior Court* (1985) 39 Cal.3d 633, 638; parenthetical material in original.) This Court has explained that the two sentences together "establish that the sole legal avenue for resolving tax disputes is a postpayment refund action." (*Ibid.*) Thus, while the Legislature may sculpt the general contours of a refund action, the explicit language of article XIII, section 32 prohibits the Legislature from providing for a prepayment legal challenge to the validity of an underlying tax assessment.

Although this case is a post-payment tax refund case where the audit occurred after the payment of the tax, audits routinely *precede* the payment of the disputed tax and result in subsequent tax assessments. By imposing an evidentiary presumption and shifting the burden of proof during an audit, the lower court's decision would allow taxpayers to challenge the Board's audit determinations before the taxes are paid, a practice often referred to as "prepayment tax litigation," and one which is barred by the provisions of article XIII, section 32, which "applies if the prepayment judicial determination sought would impede tax collection." (*Western Oil and Gas Assn. v. State Bd. of Equalization* (1987) 44 Cal.3d 208, 213.)

Article XIII, section 32 is to be "construed broadly" in support of its provisions. (*State Bd. of Equalization v. Superior Court*, *supra*, 39 Cal.3d at p. 639.) The reason for barring prepayment litigation is because the state must be able to collect its revenues "so that essential public services dependent on the funds are not unnecessarily interrupted." (*Pacific Gas & Electric Co. v. State Bd. of Equalization* (1980) 27 Cal.3d 277, 283.) "[S]trict legislative control over the manner in which tax refunds may be sought is necessary so that government entities may engage in fiscal planning based on expected tax revenues." (*Woosley v. State of California* (1992) 3 Cal.4th 758, 789.) Those reasons are even more important in this challenging budgetary environment.

The decision of the Court of Appeal does not distinguish audits that follow payment from those that precede payment. If the lower court's rule stands it will apply in both cases and its application will violate the provisions of article XIII, section 32 barring prepayment lawsuits. Giving taxpayers a new right at the audit stage presumes an equivalent remedy allowing taxpayers to petition a court to enjoin or correct whatever they claim is a violation of that right. Thus, if this rule stands it would generate prepayment lawsuits challenging the Board's audit procedures and findings, the resulting judgments of which taxpayers will attempt to use against the Board in later tax-refund actions. That violates article XIII, section 32.

2. The Decision Below Is Contrary to the Rule That A Tax-Refund Lawsuit Is a Trial De Novo in the Superior Court.

In *State Bd. of Equalization v. Superior Court*, this Court held that article XIII, section 32 "establish[es] that the sole legal avenue for resolving tax disputes is a postpayment refund action." (39 Cal.3d at p. 638.) This "postpayment refund action," which is the "sole legal avenue for resolving tax disputes," is not however a review of what happened at the

audit stage or in the administrative proceedings below, it is instead a trial de novo in the superior court. (*Nast v. State Board of Equalization* (1996) 46 Cal.App.4th 343, 348 ["a refund action obviates the need for [a] 'correction' of an SBE determination because the taxpayer's contention is heard de novo in superior court"].)

Dicon's tax-refund lawsuit and the Court of Appeal's decision both ignore this important rule. Dicon's lawsuit does not allege that it was entitled to a refund because it met all of the necessary requirements for the enterprise zone credit, but rather it alleges that the Board erred at the administrative level by rejecting Dicon's vouchers during the audit and "creat[ing] an additional administrative burden on the taxpayer . . . ." (AA at p. 18, ln. 22 – p. 19, ln. 4.)[9] Dicon's lawsuit failed to state a cause of action because it alleged only that the Board erred during the audit. In a tax-refund lawsuit the court does not review the Board's actions for error at the audit or administrative level, it holds a trial de novo. "A hearing de novo literally means a new hearing. . . . It is in no sense a review of the hearing previously held, but is a complete trial of the controversy, the same as if no previous hearing had ever been held." (*Collier & Wallis, Ltd. v. Astor* (1937) 9 Cal.2d 202, 205.)

The lower court's decision sanctioned Dicon's improper focus on alleged administrative error when it held that a voucher is prima facie evidence at audit and that "[i]n such an audit, [the Board] bears the burden of rebutting the voucher's prima facie value . . . ." (Slip op. at p. 7.) The decision loses sight of the fact that Dicon filed a tax-refund lawsuit; the

---

[9] In fact, Dicon even argued in the Court of Appeal that the Board's actions at the audit stage should be reviewed under the substantial evidence test in what would essentially be a writ of mandate-type proceeding. (Dicon's Letter Brief to the court dated Feb. 20, 2009, at p. 2.) The Court of Appeal's opinion did not address this argument.

question should not be what the Board did at the audit stage, but whether the taxpayer has pled and can prove sufficient facts at the trial de novo in the superior court to establish a different amount of tax. (*People v. Schwartz* (1947) 31 Cal.2d 59, 64 [taxpayer "has the burden of proving not only that the board's determination, based upon his records, is incorrect, but also of producing evidence from which another and proper determination may be made"]; *Nast v. State Board of Equalization*, *supra*, 46 Cal.App.4th at p. 348.)

While the Legislature has the power to change the rule providing for de novo trials in tax-refund lawsuits, it did not do so in section 23622.7. The actual language of section 23622.7 says nothing at all about changing the rule that a tax-refund lawsuit is a trial de novo in superior court. This is a case where the language of the statute is clear. "If there is no ambiguity in the language of the statute, then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs." (*Lennane*, *supra*, 9 Cal.4th at p. 268; citations and internal quotations omitted.)

Other rules of statutory construction also support the Board's interpretation that section 23622.7 does not override the trial de novo rule in tax-refund lawsuits. Income tax credits are a matter of legislative grace and are strictly and narrowly construed against the taxpayer. (*Miller v. McColgan*, *supra*, 17 Cal.2d at pp. 441-442; *Great Western Financial Corp. v. Franchise Tax Bd.*, *supra*, 4 Cal.3d at p. 5; *General Motors*, *supra*, 39 Cal.4th at p. 790.) If the Board's "interpretation . . . is reasonable it must . . . be adopted. It is of no moment that the statute may be ambiguous, or that a contrary construction might also be reasonably permissible." (*Hospital Service*, *supra*, 25 Cal.App.3d at p. 406.) The lower court's decision was in error because it failed to construe section 23622.7 against the taxpayer and it rejected the Board's reasonable interpretation.

Moreover, courts will not presume that the Legislature intended to overturn long-established principles of law unless that body makes its intention clear by declaration or necessary implication,. (*General Motors*, *supra*, 39 Cal.4th at p. 790; *Theodor v. Superior Court*, *supra*, 8 Cal.3d. at pp. 90-92; *County of Los Angeles v. Frisbie*, *supra*, 19 Cal.2d at p. 644.) The principle that a tax-refund lawsuit is a trial de novo in superior court is well established. It is highly unlikely that the Legislature would have intended to silently overturn that rule in section 23622.7. To use this Court's words in *General Motors*, "nowhere in the statute does the Legislature indicate it wished to apply a different rule . . . . In the absence of a contrary statement, we must interpret section [23622.7] consistently with [the time-honored rule]." (*General Motors*, *supra*, 39 Cal.4th at p. 791.)

CONCLUSION

An enterprise zone voucher is not prima facie proof in a tax-refund action that a worker is a "qualified employee" under Revenue and Taxation Code section 23622.7. The decision of the Court of Appeal must be vacated and the judgment of the trial court granting the Board's demurrer without leave to amend affirmed.

Dated: November 16, 2009

Respectfully submitted,

EDMUND G. BROWN JR.
Attorney General of California
PAUL D. GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
W. DEAN FREEMAN
Supervising Deputy Attorney General

W. DEAN FREEMAN
Supervising Deputy Attorney General

Attorneys for Defendant and Respondent Franchise Tax Board

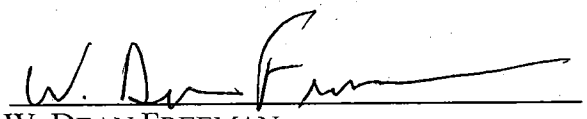
LA2007601901
60490262.doc

CERTIFICATE OF COMPLIANCE

I certify that the attached OPENING BRIEF ON THE MERITS uses a 13 point Times New Roman font and contains 9,649 words.

Dated: November 16, 2009

EDMUND G. BROWN JR.
Attorney General of California
PAUL D. GIFFORD
Senior Assistant Attorney General
GORDON BURNS
Deputy Solicitor General
W. DEAN FREEMAN
Supervising Deputy Attorney General



W. DEAN FREEMAN
Supervising Deputy Attorney General

Attorneys for Defendant and Respondent Franchise Tax Board

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: **Dicon Fiberoptics, Inc. v. Franchise Tax Board of the State of California**

Case No.: **S173860**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service that same day in the ordinary course of business.

On November 16, 2009, I served the attached **OPENING BRIEF ON THE MERITS** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the internal mail collection system at the Office of the Attorney General at 300 South Spring Street, Suite 1702, Los Angeles, CA 90013, addressed as follows:

Thomas R. Freeman, Esq.
Bird, Marella, Boxer, Wolpert, Nessim,
Drooks & Lincenberg, P.C.
1875 Century Park East, 23rd Floor
Los Angeles, CA 90067-2561
(*Attorneys for Plaintiff and Appellant*)

Marty Dakessian, Esq.
Akerman Senterfitt LLP
725 South Figueroa Street, 38th Floor
Los Angeles, CA 90017
(*Attorneys for Plaintiff and Appellant*)

Amy L. Silverstein, Esq.
Edwin Park Antolin, Esq.
Silverstein & Pomerantz LLP
55 Hawthorne St., Suite 440
San Francisco, CA 94105-3910
(*Attorneys for Amicus Curiae Deluxe Corp.*)

LaShelle T. Wilson, Esq.
The California Credits Group LLC
234 E. Colorado Blvd., Suite 700
Pasadena, CA 91101

The Honorable Mel Red Recana
Department 45
Los Angeles County Superior Court
111 North Hill Street
Los Angeles, California 90012

William Hilson, Tax Counsel
Franchise Tax Board
Legal Department
P.O. Box 1720 MS: B-17
Rancho Cordova, CA 95741-1720

Clerk, Court of Appeal ***(Hand-delivered)***
Second Appellate District, Div. 8
300 South Spring Street, 2nd Floor
Los Angeles, California 90013

I declare under penalty of perjury, under the laws of the State of California, the foregoing is true and correct and that this declaration was executed on November 16, 2009, at Los Angeles, California.

ROSITA V. EDUARDO
Declarant

Eduardo
Signature

60451872.doc