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Class Actions Practice

To Tax or Not to Tax

The California Supreme Court's View Of a Cup Of Coffee

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If the California Supreme Court calls a system of tax regulations "arcane," only a paraphrase of Hamlet will do:

"To Tax or not to Tax."

In California, order a single cup of coffee and take it offsite to drink? No sales tax.

But order it with a croissant and sit down at the retail location to eat and drink? Sales tax.

What is a retailer to do?

According to the California Supreme Court, the retailer in this "arcane" context can pay the tax on all of these purchases and then remit payment to the state. Paying the state activates a statutory "safe harbor" which almost completely immunizes the retailer from liability for charging sales tax where no sales tax was actually due.

On May 1, 2014, the California Supreme Court in *Loeffler v. Target Corporation* narrowly affirmed, in a 4-3 decision, the dismissal of a class action lawsuit against Target in which Plaintiffs sought to recover sales taxes they claimed they paid Target for purchases of individual cups of coffee "to go."

In California, single cups of coffee sold for offsite consumption ("to go") are not subject to the state sales tax. Single cups sold for onsite consumption are subject to the state sales tax. Plaintiffs sued Target under California's unfair competition and consumer protection statutes (Business & Professions Code section 17200 *et seq.* and Civil Code section 1750 *et seq.*) claiming that Target had charged sales tax on their purchase of coffee for offsite consumption. According to the suit, Target's charging of tax where no tax was due amounted to consumer fraud, particularly if Target kept the tax without remitting it to the state. Plaintiffs sought certification as a class action.

Target defended by arguing that it collected taxes on all such sales, regardless of where consumption was to occur and that it then properly paid the state. Target argued that it was nearly impossible to know where the consumer was actually going to consume the beverage, so it treated all such transactions as taxable. In the words of an obviously sympathetic California Supreme Court: "Rather than keep track of what its customers do with each cup of hot coffee to go, it is far simpler and less costly for Target to collect sales tax reimbursement on every sale and remit those amounts to the Board [of Equalization]." *Loeffler, et al. v. Target Corporation*, No. S173972, 2014 WL 1714947 (Cal. May 1, 2014).

Plaintiffs lost on all counts.

First, Plaintiffs undercut their case by misstating that they as the consumers were the taxpayers subject to the sales tax and that "paying" a tax when none was due amounted to consumer injury inflicted by Target – particularly if Target was not actually relaying what it collected to the Board of Equalization, the

agency charged with administering California's sales tax. However, the Court pointed out that California sales tax is imposed exclusively on retailers (*i.e.*, Target), though retailers can choose to require sales tax "reimbursement" from customers (*i.e.*, the would-be class members). Plaintiffs were not, as they claimed, the actual taxpayers.

Second, while the Court stated it was sympathetic to consumer protection laws generally, it indicated that maintaining consistency in tax administration was an even greater imperative, and that it couldn't allow lawsuits to proceed that would sidestep the specific and detailed procedures for resolving tax disputes, something that could possibly produce different tax consequences depending on the case. The tax structure needs consistency, said the Court, and consumer class actions alleging improper tax collections would produce inconsistency.

The Court summarized what it referred to as the "arcane" state of what is and isn't taxable, studied the histories of various legislative provisions, including both the old and the current statutes, and concluded:

1. The retailer, not the consumer, is the taxpayer.
2. While the consumer may "pay" something marked a "sales tax" on receipts, payment of this "sales tax" is actually only a reimbursement by the consumer to the retailer, since only the retailer has a legal duty to pay sales taxes.
3. Once the retailer pays sales tax due, the retailer is not, under the relevant statute, liable for mistaken collections of "reimbursement" from consumers regardless how they may be marked on the receipt. This is the statutory "safe harbor" created by Revenue and Taxation Code section 6901.5 and fully relied on by the Court.

Target, in prevailing, likely found it reassuring that the California Board of Equalization filed a friend of the Court brief supporting its position. But in the end, the Court was primarily guided by the state's tax code, as frequently amended and "arcane" as it is. The Court gave full voice to legislative intent and was not persuaded even by an "incorrect" collection of a sales tax (or reimbursement). The statutory "safe harbor" became the ultimate trump card. Once a retailer remitted a tax reimbursement to the state, the "safe harbor" eliminated liability for incorrect collection by the retailer.

Justice Liu dissented. He wrote that *Loeffler* wasn't "really a tax case." Instead, in his view, it was about consumer protection. He viewed the majority opinion as "blessing an arrangement that mutually benefits retailers and the state treasury at the expense of everyday consumers." In his view, Target was misrepresenting to consumers that a tax was due, and that it was required to collect and remit that tax.

California retailers (as well as those from states with similar tax structures) should take comfort in the *Loeffler* decision. The gist of *Loeffler* is not what transactions are or are not taxable, but rather the potent effect that retailer tax payment to the state has. It enables the retailer to claim the protection of the Revenue and Taxation Code's "safe harbor," providing a complete defense to allegedly incorrect charges of sales tax.

This case might have had a very different result if Target had been collecting a tax that it did not subsequently remit to the state – as there would then have been no basis to claim protection of the "safe harbor." The Court also left open the possibility of a consumer lawsuit to compel retailers to pursue refund claims directly against the state to recover taxes paid on nontaxable items. *See Javor v. State Board of Equalization* 12 Cal.3d (Cal. 1974).

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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