

## Nordstrom's Preliminary Injunction Denied – VCI 2 Is Still On

Author: Brian W. Toman, Partner, San Francisco

Author: Marty Dakessian, Partner, Los Angeles

Author: Kyle O. Sollie, Partner, Philadelphia

Author: Mike Shaikh, Associate, Los Angeles

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With just one week left before the end of California's second Voluntary Compliance Initiative ("VCI 2"), a trial court considered whether the VCI 2 compliance period should remain open past October 31 pending a decision on whether one of the key provisions of VCI 2 is constitutional. VCI 2 is California's second and most recent initiative whereby taxpayers can come forward to report and pay outstanding liabilities related to "abusive tax avoidance transactions" and "offshore financial arrangements."<sup>1</sup> Taxpayers who come forward under VCI 2 are relieved of most penalties.<sup>2</sup> In exchange, taxpayers who come forward cannot claim refunds for amounts paid under VCI 2.

In *Nordstrom v. State of California*,<sup>3</sup> the taxpayer is arguing that the prohibition on refund claims requires taxpayers to forfeit their First Amendment and Due Process rights to appeal. Forcing taxpayers to concede such rights or potentially subject themselves to new penalties chills the exercise of constitutional rights. Because VCI 2 gives a taxpayer only a few more days before it has to decide whether to forfeit its rights or avoid new penalties, the taxpayer in *Nordstrom* was seeking a preliminary injunction that would extend the deadline for participating in VCI 2 through the conclusion of the trial on this matter.

The trial court denied the taxpayer's motion for a preliminary injunction on procedural and substantive grounds. The judge ruled that the issue involved in this case is money-payment of taxes to the state. Thus, the proper avenue to vindicate the taxpayer's constitutional rights was in a legal, as opposed to an equitable, action for a refund. The judge, however, set trial for March 26, 2012, for a declaratory relief action in which the taxpayers are seeking a declaration that the refund claim prohibition is invalid.

This action appears to have opened the door for a possible post-deprivation hearing with respect to the refund-claim prohibition in VCI 2. Many taxpayers currently facing penalties resulting from alleged abusive tax avoidance transactions and offshore tax arrangements are still better off filing under VCI 2 and benefiting from the abatement of penalties. However, to the extent that taxpayers are backed into a corner to pay taxes that are otherwise not due, this ruling may offer a small glimpse into future litigation involving recourse through a refund claims.

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1. California Revenue and Taxation Code § 19161, *et seq.*
  2. The Large Corporate Understatement Penalty and the Amnesty Interest Penalty under California Revenue and Taxation Code sections 19138 and 19777.5, respectively, are not waived under VCI 2.
  3. Los Angeles Superior Court Dkt. No. BS133291.

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