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8 **THE SUPERIOR COURT OF THE STATE OF ARIZONA**
9
10 **IN THE ARIZONA TAX COURT**

11 HAROLD VANGILDER; DAN NEIDIG; and
12 ARIZONA RESTAURANT ASSOCIATION,

13 Plaintiffs,

14 v.

15 ARIZONA DEPARTMENT OF REVENUE;
16 PINAL COUNTY; PINAL COUNTY
17 REGIONAL TRANSPORTATION
18 AUTHORITY,

19 Defendants.

Cause No. TX2017-000663

**RESPONSE TO MOTION FOR
ISSUANCE OF DECLARATORY
JUDGMENT**

(Assigned to the
Honorable Christopher T. Whitten)

19 Defendant, the Arizona Department of Revenue (“Department”), hereby files this
20 Response to the Motion for Issuance of Declaratory Judgment filed by Plaintiffs. This
21 Response is supported by the following Memorandum of Points and Authorities.

22 **Memorandum of Points and Authorities**

23 **I. Facts.**

24 On June 5, 2017, Defendant, the Pinal Regional Transportation Authority (“RTA”),
25 passed Resolution No. 2017-01 (“Resolution”) requesting that Defendant, Pinal County
26 (“County”), schedule and conduct a countywide special election on November 7, 2017

1 regarding: (1) the adoption of a regional transportation plan; and (2) the levy of a transportation
2 excise tax pursuant to A.R.S. § 42-6106. The Resolution stated that the tax was to be levied:

3 at a rate equal to one-half percent (0.005%) of the gross income from the business
4 activity *upon every person engaging or continuing in the business of selling*
5 *tangible personal property at retail*; provided that such rate shall become a
6 variable or modified rate such that when applied in any case when the gross
7 income from the sale of a single item of tangible personal property exceeds ten
8 thousand dollars (\$10,000), the one-half percent (0.005%) tax rate shall apply to
the first ten thousand dollars (\$10,000), and above ten thousand dollars (\$10,000),
the measure of tax shall be a rate of zero percent (0%), pursuant to 42-6106,
needed to fund the Plan.

9 (Emphasis added.)

10 Pursuant to A.R.S. § 48-5314(C), the Pinal County Board of Supervisors (“Board”) was
11 obligated to prepare, print and distribute to households a publicity pamphlet that provided,
12 among other things, a summary of the principal provisions of the issue presented to the voters,
13 including the rate of the transportation excise tax and the form of the ballot. The publicity
14 pamphlet prepared and mailed by the Board (“Pamphlet”) stated that excise taxes would be
15 levied upon *all* transaction privilege tax classifications set forth in A.R.S. Title 42, Chapter 5,
16 Article 2 (A.R.S. §§ 42-5061 through -5076), as well as upon jet fuel taxes under to A.R.S. §
17 42-5352(A), and on the use or consumption of electricity or natural gas by customers in Pinal
18 County who are subject to use tax under A.R.S. § 42-5155. This was not consistent with the
19 Resolution, which authorized the Board to prepare and distribute a publicity pamphlet and
20 sample ballot with respect to the levy of a transportation excise tax only on the retail
21 classification.

22 In the Pamphlet, tax rates were set forth for all of the tax classifications identified to be
23 applied to the appropriate tax bases, except that the “rate” for the retail classification (as set
24 forth in the Resolution) excluded from the tax base amounts over \$10,000 from the sale of a
25 single item of tangible personal property. In particular, the “rate” was a 0.5% tax on gross
26

1 income amounts up to \$10,000 for a single item sold and 0% tax on amounts for single items
2 over \$10,000, effectively excluding such income from taxation.

3 Notwithstanding the Pamphlet's description stating that the tax would apply to all
4 classifications, the Pamphlet's sample ballot followed the Resolution by stating that taxes
5 would be levied only on the retail classification at the 0.5% and 0% rates. The actual ballot
6 language voted on by county voters (Proposition 417) tracked the Pamphlet's sample ballot
7 language and the Resolution's, stating that a "yes" vote would levy a tax only upon the retail
8 classification, excluding revenues from single items over \$10,000 from the tax base. At the
9 November 7 election, voters approved the adoption of a regional transportation plan
10 (Proposition 416) and narrowly approved Proposition 417.

11 The Department initially interpreted the tax as only applying to the retail classification
12 since that was the only classification identified in the ballot. However, the County contends
13 that the scope of the tax is determined by the Pamphlet language (and not the ballot language)
14 and, in a 2/22/18 resolution sent to the Department (Resolution 2018-01), has demanded the
15 Department to begin collecting the tax on all classifications on April 1, 2018. This dispute is an
16 election law issue (at least in part) that does not concern the Department. The Department has
17 complied with the County's demand by publishing tax rate tables for April 2018 consistent with
18 Resolution 2018-01, and will accept filings and payments of this disputed tax remitted by
19 taxpayers from all classifications accordingly. The Department's actions are reflective of the
20 Department's role as tax administrator and not an endorsement of the correctness of the
21 County's position, which is a subject of this litigation.

22 Finally, for what it may be worth, Plaintiffs misrepresent the Department's position as to
23 the propriety of declaratory relief by contending that the Department did not object to the
24 taxpayers seeking declaratory relief in TX2014-000129, the "Solar City case." The Court can
25 take judicial notice of the Department's Motion to Dismiss filed in that case on 2/19/2015 in
26 which the Department argued that Plaintiffs were not entitled to file a lawsuit seeking

1 declaratory relief given the existence of a statute, A.R.S. § 42-11005, that prescribed the means
2 by which taxpayers can challenge the legality of their property taxes. The tax court denied the
3 Department’s Motion to Dismiss in Solar City, and the court of appeals declined to accept
4 jurisdiction of the Department’s special action (April 29, 2015 Order, No. 1 CA-SA 15-0112).
5 This is not a record of acquiescence to litigating disputes over tax laws in declaratory relief
6 actions.

7 **II. Law and Argument.**

8 **A. A Declaratory Judgment Is Not Proper in Tax Cases, but Due to the Unusual** 9 **Election Law Issues Present in this Case, the Department Does Not Object to** 10 **Summary Judgment Procedure to Determine the Validity and Scope of the** 11 **Tax.**

12 Plaintiffs err by assuming a declaratory judgment action is proper in tax cases. Several
13 cases have rejected the propriety of declaratory relief actions in tax cases. Indeed, declaratory
14 actions cannot be used to avoid the requirement that taxes must be paid before challenging their
15 legality. *Estate of Bohn v. Scott*, 185 Ariz. 284, 291 (App. 1996) (holding Arizona’s version of
16 the Uniform Declaratory Judgment Act, A.R.S. §§ 12-1831 through -1836, does not allow for
17 declaratory relief in state tax cases where adequate legal remedy exists and adopting the U.S.
18 Supreme Court’s reasoning that “[d]eclaratory relief in state tax cases might throw tax
19 administration into disarray, and taxpayers might escape the ordinary procedural requirements
20 imposed by state law.”). See also *Church of Isaiah 58 Project of Ariz., Inc. v. La Paz County*,
21 233 Ariz. 460, 467, ¶ 28 (App. 2013) (“Our legislature has determined that a taxpayer may not
22 seek declaratory relief regarding the validity or amount of a tax without first paying the taxes
23 assessed.”).

24 The only possible exception to the requirement that transaction privilege cases must be
25 litigated administratively, then appealed to court, is when there is no semblance of authority for
26 the tax. *Church of Isaiah*, 233 Ariz. at 464-65, ¶¶ 19-20 (discussing the limited situations in
which injunctions against a tax can be issued). However, the Department must still administer

1 disputed taxes and collect revenues during periods of challenge, which often take many years.
2 To fail to do so would imperil the viability of government by delaying revenue collection every
3 time there is a facial challenge to the validity of an enactment.¹

4 The cases cited by Plaintiffs are not on point. In *Pimalco, Inc. v. Maricopa County*, 188
5 Ariz. 550, 553 (App. 1997), the court mentions that in a different litigation, “Maricopa County
6 brought a declaratory judgment action against the state to challenge the constitutionality of the
7 new exemptions.” Clearly, the requirement to litigate taxes administratively at the Department
8 does not apply to litigation between the state and a county over a constitutional issue, in which
9 the county is not a taxpayer and faces neither an assessment nor a denial of a refund claim.
10 Such a posture places *Pimalco* outside of normal tax disputes.

11 While the procedural history is not clear, in *Scottsdale Princess Partnership v.*
12 *Department of Revenue of the State of Arizona*, 191 Ariz. 499, 500 (App. 1997) the taxpayer
13 “filed separate actions against the County and the [Department], charging that the assessments
14 were illegal and seeking refunds.” There is nothing in the case indicating that the case was a
15 declaratory relief action or that any necessary administrative remedies had been bypassed
16 before the refund claim ended up in court.

17 Notwithstanding the general prohibition against declaratory judgment actions in tax
18 matters, the issues presented here appear to be legal disputes over whether there is in fact a
19 lawful tax in existence, given alleged improprieties in the election process and the substance of
20 the tax or purported tax. If the tax is void ab initio based on either election law issues, or
21 because the substance of the tax is inconsistent with A.R.S. § 42-6106, the Department will not
22 object to the validity and general scope of the tax being adjudicated as alleged by Plaintiffs in
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25 ¹ There is almost always someone who is not happy about a new tax, and activist groups who
26 do not like a tax could pursue challenges. Hindering revenue collection during a challenge
could imperil the government’s ability to operate and is unnecessary since the ability to dispute
assessments or pay and seek refunds provides adequate remedies in most cases.

1 their complaint.² As the critical events and documents are all public records, the Department
2 assumes that a facial challenge to the tax can be litigated without taxpayer-specific claims being
3 present. And none of the challenges to the tax concern a disputed assessment or disputed
4 denied refund claim, claims for which administrative remedies clearly must be exhausted.

5 **B. The Variable “Rate” of 0% Is Unlawful Because the County Cannot Exempt**
6 **Portions of the Retail Tax Base from Taxation.**

7 Plaintiffs have attached to their Motion the Department’s disclosure statement which
8 states the Department’s positions on the legal issues, and the Department has also addressed
9 these issues in its 3/19/18 Response to the Plaintiff’s Motion for Preliminary Injunction. The
10 Department incorporates those responses into this Response and will summarize those positions
11 and address some issues not earlier briefed.

12 **1. The “Variable Rate” Language in A.R.S. § 42-6106 Does Not Permit a**
13 **County to Exclude Certain Income from a Tax Base Created by the**
14 **Legislature.**

15 The attempt to exclude proceeds from the retail classification tax base is violative of
16 state law that permits counties to levy transaction privilege taxes using State-prescribed TPT
17 classifications. The laws allowing counties to adopt rates and apply them to Arizona’s TPT
18 classifications, including A.R.S. § 42-6106, only allow counties to adopt a rate to apply to
19 existing tax bases but do not allow counties to alter the tax base adopted by the Legislature.
20 The Department thus agrees with Plaintiffs that this alteration of tax base is not a lawful
21 “variable rate” under A.R.S. § 42-6106(C). For any given tax period (*i.e.*, one month), there

22 ² The applicability of the tax to any particular business cannot be established in this proceeding,
23 though whether the tax applies to particular classifications can be determined. This proceeding
24 cannot establish a right to a refund of tax. A taxpayer must bring refund claims at the
25 Department to establish a right to a refund. A.R.S. § 42-1118(E); *City of Phx. v. Fields*, 219
26 Ariz. 568, 573, ¶ 19 (2009); *Stearns v. Ariz. Dep’t of Revenue*, 231 Ariz. 172, 178-79 (App.
2012); *Estate of Bohn v. Waddell*, 174 Ariz. 239, 245 (App. 1992). Even if a tax paid was not
owed, in reviewing a refund claim, the Department may properly deny a refund, such as if other
taxes were not paid or if a claim is untimely. Individual refunds, therefore, cannot be
determined in this proceeding and will require refund claims and administrative review.

1 must be only one rate applied to the entirety of the statutory tax base, but a rate can be variable
2 for different tax periods. An allowable “variable” rate does not encompass charging one rate on
3 part of the tax base and a zero rate on another part of the tax base for the same taxing period,
4 which has the effect of excluding part of the legislatively prescribed tax base from the tax.

5 Further, in the event the Court holds that the only tax lawfully levied by the voters in
6 November is the retail tax set forth in the ballot that tax by itself appears to violate A.R.S. § 42-
7 6106(B) which provides that:

8 The tax shall be levied and collected . . . [a]t a rate of not more than ten percent of
9 the transaction privilege tax rate prescribed by section 42-5010, subsection A in
10 effect on January 1, 1990 *to each person engaging or continuing in the county in a
business taxed under chapter 5, article 1 of this title.*

11 As set forth in Chapter 5, Article 2 of Title 42, sixteen businesses are taxed under Chapter 5,
12 Article 1 of Title 42, including the retail classification found in A.R.S. § 42-5061. A tax on
13 fewer than all sixteen of the business classes thus appears to violate A.R.S. § 42-6106(B).

14 Finally, the Department disputes Plaintiffs’ claim that the County was attempting to
15 create a new classification when it exempted from taxation all amounts \$10,000 earned from
16 the sale of any one item. The Resolution, the ballot, and Pamphlet do nothing to define any
17 new classification beyond referring to existing TPT classifications. That said, the Department
18 does agree with Plaintiffs that counties cannot create new TPT classifications under A.R.S. §
19 42-6106 or otherwise.

20 **2. The Exclusion of Proceeds from the Retail Tax Base Does Not Violate**
21 **Equal Protection and Are Not Special Laws.**

22 Equal protection challenges are subject to rational basis review. *See US W. Commc’ns,*
23 *Inc. v. City of Tucson*, 198 Ariz. 515, 525 (App. 2000). Preventing sales from “fleeing” a tax
24 jurisdiction is such a rational basis and thus is not an equal protection violation. Notably, the
25 model city tax code option V allows a city or town to levy a transaction privilege tax on only a
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1 portion of a transaction. See <https://modelcitytaxcode.az.gov/articles/4-460.htm>.³ And as
2 anyone who reads tax statutes can ascertain, taxes (whether income, sales, transaction privilege
3 tax, property tax, etc.) are frequently not equal and exemptions are common.

4 The argument that sales on smaller dollar purchases are as likely to flee a higher sales
5 tax as large purchases makes little sense. On a \$100 purchase, a 0.5% tax is fifty cents. On a
6 \$1,000 purchase, the tax is five dollars. It seems rational that a smaller-purchase consumer
7 would avoid spending money on gas and time to save a small amount of tax. However, on a
8 \$500,000 motor home, the potential savings would be \$2,500 if the 0.5% tax could be avoided,
9 which might cause a sales shift if this could be avoided. This provides a rational basis for
10 setting limits above which the tax would not apply.

11 Plaintiffs are also incorrect about the \$10,000 limit on the retail tax base being void as a
12 special law, and their cases are not on point. “Prohibited special legislation, on the other hand,
13 unreasonably and arbitrarily discriminates *in favor of* a person or class by granting them a
14 special or exclusive immunity, privilege, or franchise.” *Republic Inv. Fund I v. Town of*
15 *Surprise*, 166 Ariz. 143, 148 (1990) (internal cite omitted). And in addition to whether the
16 classification has a reasonable basis, courts evaluate “(1) whether the classification
17 encompasses all members of the relevant class; and (2) whether the class is elastic, allowing
18 members to move into and out of the class.” *Id.* at 149.

19 Here, there is no such grant. There is no constitutional requirement in setting up a TPT
20 that all revenue of a business be taxed. See the numerous untaxed revenues found in A.R.S. §§
21 42-5061(A) and (B) for example. Such exemptions and deductions are available to anyone
22 whose sales qualify. Here, all retailers selling a single item over \$10,000 are treated equally,
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24 _____
25 ³ The County argues that the Model City Tax code provision exemplifies why their retail tax on
26 only the first \$10,000 in income is lawful. Cities and towns can levy such taxes because they
are authorized by law to do so. There is no comparable provision under state law that permits
counties to exempt certain proceeds from a legislatively defined tax base.

1 and there is no limit on who can join that class by selling such items or leave it by not selling
2 such items.

3 Plaintiffs' equal protection and special law challenges are wholly without merit. The
4 Arizona Constitution simply does not require that all revenues be taxed or that they be taxed
5 equally.

6 **3. Election Law Issues Also Raise Questions About Whether the Tax Was**
7 **Legally Enacted.**

8 The Department is of necessity obligated to follow the County's direction as to the scope
9 of the tax during any administrative challenge at this stage.⁴ Therefore, in any refund claim or
10 protest of an assessment, the Department would anticipate following the law as the County sees
11 it. However, there are self-evident inconsistencies between the Resolution and the Ballot
12 (purporting to tax only retail with the base limitations) and the Pamphlet and Resolution 2018-
13 01 (purporting to tax all classifications). The Department will leave it to the County and
14 Plaintiffs to argue these issues.

15 The Department does note that, if the exclusion of proceeds from the retail tax base is
16 found to be unlawful (as the Department argues above), the retail tax should be invalidated
17 regardless of whether the Ballot or Pamphlet controls unless the exclusion of proceeds from the
18 base can be severed. The problem with severance is that the voters who voted for the tax may
19 have not done so without the \$10,000 limit and would not have voted for a tax without that
20 limit. Courts will sever invalid portions of a statute if the valid and invalid portions "are not so
21 intimately connected as to raise the presumption the legislature would not have enacted one
22 without the other, and the invalid portion was not the inducement of the act." *Randolph v.*
23 *Groscost*, 195 Ariz. 423, 427, ¶ 14 (1999). However,

24 _____
25 ⁴ If the Department agreed with a taxpayer that the law was illegal or did not apply to a
26 classification and refunded the tax, it could face suit from the County for failing to enforce the
law. Therefore, barring a final and binding court ruling, the Department will follow the
County's interpretation.

1 Applying the latter part of the severability test in a disciplined manner to
2 enactments adopted by the voters, however, proves to be a nearly impossible task.
3 When we consider whether the legislature would have adopted the valid portion of
4 a statute absent the invalid portion, we can look to the statute’s legislative history.
5 *See Hull v. Albrecht*, 192 Ariz. 34, 39-40, 960 P.2d 634, 639-40 (1998). When the
6 voters approve a measure, however, we have no legislative history to guide us in
7 discerning voter intent. Indeed, each voter’s intent may be distinct from that of
8 other voters. For that reason, in deciding whether to sever the invalid portion of a
9 measure adopted by popular vote and uphold the remaining, valid portion, we will
10 apply the following test. We will first consider whether the valid portion,
11 considered separately, can operate independently and is enforceable and workable.
12 If it is, we will uphold it unless doing so would produce a result so irrational or
13 absurd as to compel the conclusion that an informed electorate would not have
14 adopted one portion without the other.

15 195 Ariz. at 427, ¶ 15. It is not clear that this standard can be applied to the instant case, and if
16 it is applicable, it is not clear whether a lawful tax within the limits of A.R.S. § 42-6106 was
17 adopted. In the first instance, the court would need to determine what “measure” was adopted
18 and whether it will enforce what remains after any offending provisions are stricken.

19 **III. Conclusion.**

20 The Department takes no position on the election law issues raised by Plaintiffs, which
21 are not tax issues. The Department requests that the Court deny Plaintiffs’ request for
22 declaratory relief that the Proposition 417 tax violates the special law and equal protection
23 clauses of the State Constitution and the Equal Protection clause of the U.S. Constitution.
24 Finally, the Department agrees with Plaintiffs that A.R.S. § 42-5061 does not authorize
25 counties/their voters to exempt portions of the retail tax base from taxation under the guise of
26 adopting and applying a 0% rate on certain portions of the retail tax base defined by the
Legislature.

1 DATED this 1st day of May, 2018.

2 MARK BRNOVICH
3 Arizona Attorney General

4 /s/ Scot G. Teasdale
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13 ORIGINAL of the foregoing e-filed with the
14 Court this 1st day of May, 2018.

15 COPY of the foregoing e-delivered
16 this 1st day of May, 2018, to:

17 Honorable Christopher Whitten
18 Judge of the Arizona Tax Court
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