# IN THE SUPREME COURT OF ARIZONA

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| DOVE MOUNTAIN HOTELCO, LLC, d/b/a RITZ-CARLTON DOVE MOUNTAIN HOTEL AND SPA, a Delaware LLC, and HSL COTTONWOOD RC HOTEL, LLC, an Arizona LLC,<br><br>Plaintiffs/Appellants,<br><br>v.<br><br>ARIZONA DEPARTMENT OF REVENUE, an agency of the State of Arizona,<br><br>Defendant/Appellee. | Arizona Supreme Court Case No.<br><br>Court of Appeals Division One Case No. 1 CA-TX 22-0003<br><br>Maricopa County Superior Court Case No. TX2019-000448 |

# PETITION FOR REVIEW OF OPINION OF THE COURT OF APPEALS


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## INTRODUCTION

The Court should grant review to resolve the tension between the Court of Appeals' Opinion in this case and this Court's longstanding decision in *State Tax Commission v. Consumers Market,* 87 Ariz. 376 (1960). In *Consumers Market*, this Court held that a rewards program offered by a grocery store is not subject to transaction privilege tax ("TPT"). Despite this precedent, the Court of Appeals held in this case that a nearly-identical rewards program offered by a hotel *is* subject to TPT. (Opinion ¶ 1). At the outset, there is a significant doubt that the Court of Appeals' decision in this case is correct. The majority Opinion attempted to distinguish this case from *Consumers Market* by pointing to three factual differences between the cases, (Opinion ¶¶ 18-20), but as the well-reasoned Dissent clarifies, it did not satisfactorily explain why these factual differences mean that this case is not controlled by *Consumers Market*. (Dissent ¶¶ 35-41). The Opinion muddies 70 years of precedent since *Consumers Market*, opens the door for double taxation of loyalty programs, and the issue is likely to recur given the popularity of customer loyalty rewards programs in every consumer industry in Arizona.

Importantly, the Opinion's impact is not limited to hotels, and could extend to any taxpayer that offers a rewards program (including credit card companies, airlines, restaurants, and retailers). Furthermore, it is unclear under the Opinion which of the three factual differences that it pointed to are material to the legal

analysis—in other words, is *Consumers Market* limited to its precise facts, or is there a key factual difference that renders a rewards program taxable? The Opinion thus creates uncertainty for a broad swath of taxpayers.

In accordance with ARCAP 23(d)(3), this case provides a good vehicle for resolving the question of whether a rewards program is subject to TPT. This case was decided on cross-motions for summary judgment and involves a pure question of law with no factual disputes. (Opinion ¶ 2) ("The relevant facts are not disputed."); (Dissent ¶ 47) ("Under these undisputed facts, I would hold that *Consumers Market* controls . . .").

## ISSUES FOR REVIEW

1. Did the Court of Appeals err when it equated post-tax funds reserved to reimburse the hotel for the cost of future awards to be "gross income" under A.R.S. §§ 42-5070 and -5001(4), (7) when the funds were paid to the hotel upon point redemption?

2. Did the Court of Appeals err when it equated Dove Mountain's 4.5% remittance to the Marriott rewards program as a payment for membership to a third-party vendor?

3. Did the Court of Appeals err when it decided that *Consumers Market* did not serve as controlling precedent and established that the post-tax funds at issue in this case should be taxed a second time when being returned to the hotel upon redeemed free hotel stays?

## FACTS MATERIAL TO CONSIDERATION OF THE ISSUE

### A. Dove Mountain Participates in the Marriott Rewards Program That Incentivizes Consumers to Use Marriott-Branded Hotels By Awarding Them Points They Can Redeem for Future Stays.

The taxpayer in this case, Dove Mountain, owns and operates a Marriott-branded hotel. Marriott's branded hotels – including Dove Mountain – participate in a rewards loyalty program for Marriott hotel guests (the "Rewards Program"). (App.0029 - 0030) The Rewards Program increases lodging at Marriott branded hotels by rewarding members with points for paid stays. (App.0030) Rewards Program members ("Members") earn points from paid hotel stays and other activities. (App.0030 - 0032) Members can redeem points for "free" lodging at Marriott branded hotels. (App.0030 - 0032)

Marriott Rewards, LLC ("Marriott Rewards") operates and administers the Rewards Program. (App.0030 - 0032) Marriott Hotels contribute to, and seek reimbursement from, the Rewards Program. (App.0030 - 0032) Specifically, each hotel agrees to: (1) fund the Rewards Program points by contributing a percentage of a Member's lodging bill to the program; and (2) provide free lodging when a Member redeems reward points. (App.0030 - 0032) The cost of the free rooms are included in the lodging prices the hotels charge all Members for their hotel stays. (App.0139) If the Rewards Program was ever terminated, the contributions are to be returned to the hotels. (App.00018, 0091 - 0093)

Specific to Dove Mountain, each time a Member pays for a room at the hotel, Dove Mountain remits 4.5% of the Member's hotel lodging expenses to the Rewards Program ("Contribution Payment") for the points earned by the Member. (App. 0032) Marriott Rewards holds the Contribution Payment, minus marketing and administrative fees, for future rewards. (App.0032) After a Member redeems their points, Dove Mountain submits a request for Reimbursement to Marriott Rewards for the points redeemed for lodging at the hotel. (App.0030 - 0032)

### B. Dove Mountain Sought a Refund from the Department of $162,148.61 of Tax Paid on Rewards Program Reimbursements, Which the Department Denied.

Dove Mountain's Contributions of 4.5% are the same lodging receipts Dove Mountain reported and paid tax on under Arizona's transaction privilege tax lodging classification (Ariz. Rev. Stat. § 42-5070) (hereinafter, the "lodging TPT"). (App.0030 - 0032) During the periods at issue, April 1, 2021 to February 29, 2016 ("Tax Period"), Dove Mountain not only paid lodging TPT on Contribution Payments, but also on Reimbursements – thus, paying tax on the funds deposited with Marriott Rewards and then paying the tax again when the funds were withdrawn. (App.0030 - 0032)

On May 19, 2016, Dove Mountain requested a refund of $162,148.61 from the Arizona Department of Revenue ("Department") for the lodging TPT paid on the Reimbursement Payments during the Tax Period. (App.0029) Dove Mountain's

refund claim asserted that no tax was due on the Reimbursement Payments because (1) the Reimbursements do not constitute consideration for hotel occupancy; (2) the gross receipts associated with the points awarded to Members were from prior hotel stays subject to lodging TPT at the time they were received; and (3) no money is paid by a Member when he or she redeems points for complimentary stays.

On June 9, 2017, the Department denied Dove Mountain's claim for refund, without explanation. (App.0029 - 0030)

### C. Dove Mountain Sued in the Superior Court to Seek the Refund the Department Denied, and Dove Mountain and the Department Filed Cross-Motions, Based Largely on Stipulated Facts.

On August 8, 2019, Dove Mountain timely filed its Complaint concerning the Rewards Program refunds. (App.0174) Dove Mountain filed a motion for summary judgment on June 25, 2021, arguing that the Arizona Supreme Court's decision in *Consumers Markets* prohibited the Department from taxing Reimbursement Payments. (App.0013) The Department filed a cross-motion for summary judgment on July 29, 2021, arguing that Marriott Rewards was unlike the arrangement in *Consumers Market*. (App.0154) The parties stipulated to the material facts in this case, including the following:

> 25. Under the Participation Agreement, program members earn points for each dollar they pay on the amount of the folio (with some exceptions), and Marriott hotels pay a percentage of room revenue plus a tax component to the Rewards Program for paid stays.

26. Marriott hotels also provide hotel rooms when Reward Program points are redeemed for lodging.

27. To pay for earned points provided to Rewards Program members, all Marriott hotels remit a percentage of each Rewards Program member's hotel lodging to the Rewards Program.

29. The payment equal to 4.5% of a Reward Program member's lodging Receipts that Dove Mountain contributed to the Reward Program, are receipts on which Dove Mountain reported and paid lodging TPT on.

32. The Rewards Program remits payments to the participating hotels under the Rewards Program for points redeemed for lodging.

(App.0031 - 0032)

On February 1, 2022, the Superior Court granted summary judgment for the Department. (App.0003) The Superior Court found that this case was distinguishable from *Consumers Market* because "the Rewards Program pays Dove Mountain" and was not a "self-redeemer" because customers can earn points in some manner other than lodging and can redeem points for non-hotel benefits. (App.005).[1] The Superior Court did not explain why these cited distinctions render Dove Mountain's transactions taxable, though. (App.0003 – 0013)

[1] Dove Mountain did not seek a refund for TPT paid on transactions where the customer redeemed rewards points that had been earned through a method other than prior hotel stays.

### D. The Court of Appeals Affirmed the Superior Court's Rulings. Judge Furuya Dissented, and Concluded that This Case Is Indistinguishable from *Consumer Markets*.

On June 8, 2023, a split panel of the Court of Appeals affirmed the Superior Court's decision, adopting the Superior Court's analysis and adding additional analysis to the Opinion's conclusion. (Opinion ¶1) The Court of Appeals pointed to several factual distinctions between this case and *Consumers Market*, and found that these factual distinctions rendered *Consumers Market* inapplicable. (Opinion ¶¶17-22)

Judge Furuya dissented and pointed out that the majority had not made any meaningful distinctions between the Marriot Rewards Program and the program at issue in *Consumers Market*. (Dissent ¶¶35-47) The Dissent clarified that Marriott Rewards was not a third-party vendor and that the Reimbursement Payments were not "new income" subject to lodging TPT. (Dissent ¶24) Instead, the Reimbursement Payments were "post-tax reserves that are held and released by the Rewards Program for future use." (Dissent ¶24)

The Dissent further explained that even the broad definition of "gross receipts" did not include reserves, savings, or other post-tax, pre-paid funds, and to view the definition as including such funds would result in impermissible double taxation. (Dissent ¶26). This Petition for Review followed.

## REASONS TO GRANT REVIEW

### A. Review is Warranted Because the Opinion Stands In Significant Tension with this Court's Binding Precedent in *Consumers Market*

Dove Mountain is a hotel in the business of selling lodging to transients, and thus subject to taxation upon its gross income from that activity. *See* A.R.S. §§ 42-5008; 42-5010(A)(2)(a) (imposing TPT on such businesses); *see also* A.R.S. § 42-5070(A) (defining transient lodging classification); A.R.S. § 42-5070(F) (defining transient). When construing a tax statute, a court is required to apply statutorily defined meaning when applicable and give undefined words their plain and ordinary meaning. *Butler Law Firm, PLC v. Higgins*, 243 Ariz. 456, 461 ¶ 19 (2018); *see also Chaparro v. Shinn*, 248 Ariz. 138, 141 ¶ 15 (2020). In construing the lodging TPT tax, the Opinion does not follow this axiomatic principle, which necessitates this Court's review and reversal.

The Opinion incorrectly holds that the Reimbursements constitute new income to be included in Dove Mountain's "gross receipts." To arrive at this conclusion, the Opinion states "[a]lthough the members paid no money for their 'free' stays, Dove Mountain nonetheless received the full value of the lodging." (Opinion ¶14) This is incorrect. Members provide the consideration for their rewards by repeatedly staying at Marriott hotels to earn points. Thus, when a Member redeems earned points for free lodging, all of the consideration has already been received through the purchase of prior stays. To cover the cost of the future awards,

Dove Mountain sets aside 4.5% of lodging receipts on a post-tax basis by making a Contribution Payment to Marriott Rewards. When the Contribution Payment is returned to Dove Mountain as a Reimbursement, it is not a payment to secure lodging (that has already been secured), but simply the return of post-taxed funds to cover the cost of Member rewards. The presence of a program administrator and a central fund should not convert previously taxed funds earmarked for future awards into taxable gross receipts.

Although the Opinion focuses on "gross income" or "gross receipts," the analysis leaves out what it means to have a "sale." A "sale" includes a rental in exchange for consideration. A.R.S. § 42-5001(18). The consideration for the free rooms are the prior stays generating the reward points. All of the consideration is received upfront when the points are earned; there is no more consideration due or received by a hotel when points are redeemed for free lodging. All that occurs at the time redemption, is the return of monies set aside by the hotel to cover the cost of the future award.

The Opinion focuses on the wrong part of the transaction—i.e., the redemption – to find the consideration for the free lodging. Consideration has an inherent component of choice: both parties make a discretionary choice to exchange an item of value with each other. Here, once a Member redeems points for free lodging, Marriott Rewards has no choice but to reimburse Dove Mountain for its

redemption of the Member's earned reward. This is because for the price of lodging, a Member receives lodging now and in the future, and the pre-paid expense of the future award are placed with Marriott Rewards (on a post-tax basis) to be claimed by the hotel for reimbursement at a later date. Marriott Rewards simply administers the Rewards Program and is a central fund for the Marriott hotels like Dove Mountain to make deposits and withdrawals to cover the expense of future rewards.

The Dissent correctly ascribes the role of Marriot Rewards:

> No evidence was provided suggesting the Rewards Program has any other source of income. Thus, 100% of the funds that the Rewards Program uses for all its activities—administration, marketing, and disbursements to participating hotels to cover free stays—are paid exclusively out of these contributions. I do not agree that using part of the post-tax reserves for marketing and administration purposes is sufficient to transmute the remaining part into new, non-post-tax income. Whatever else the Rewards Program may do with Dove Mountain's contributions is not germane to the nature and character of the remaining funds as post-tax reserves. And I can discern nothing in the record or from counsels' statements at oral argument indicating that Dove Mountain's contributions are transmuted into new consideration sufficient to qualify as "gross income."

(Dissent ¶31)

The Opinion should be reviewed and reversed because it seeks to tax both the point-earning and the point-redemption; thereby creating an untenable and illogical outcome of double taxation, and is in conflict with this Court's holdings in *Consumers Market* and later cases, which provide that Arizona does not tax redemptions.

### B. Review is Warranted to Provide Certainty to the Many Taxpayers That Offer Rewards Programs And That Are Potentially Impacted by the Opinion

This Court should review the Opinion because it creates a conflict with longstanding precedent of *Consumers Market*. In *Consumers Market*, this Court prohibited the Department from taxing the redemption of rewards program points. There, a grocery store chain issued trading stamps to customers who purchased groceries at its stores, allowing those customers to later exchange the stamps for "free" merchandise. 87 Ariz. at 377-78. The costs of the reward program premiums were reflected in the cost of foodstuffs purchased from the grocery store. *Id.* at 379.

In holding in favor of the grocery store chain, this Court found that the grocery store's taxed gross proceeds had already accounted for the "free merchandise" and therefore it was improper to tax the grocery store a second time at the point of redemption. This Court explained:

> [T]he 'consideration' referred to in the Act has already been paid by plaintiff's customers. As a result, the transaction of exchanging trading stamps for articles of merchandise is nothing more and nothing less than a system of advanced spending and deferred enjoyment of the fruits thereof by the plaintiff's customers. This, in our view, is a matter of elementary economics, and it is difficult to imagine that the legislature could have intended that a tax be imposed in this case, for the reason that it is a part of the whole transaction of which the redemption plan is only a part, and the imposition of a tax on the latter would amount to double taxation.

*Id.* Instead of adhering to the principles of stare decisis, the Opinion notes

several non-dispositive distinctions between this case and *Consumers Market*.

First, the Opinion equates Marriott Rewards to a third-party vendor and then concludes that Dove Mountain's 4.5% Contribution is a payment for "membership" to a third-party vendor. (Opinion ¶¶ 12, 21) The Opinion also agrees with the State's argument that the Rewards Program is an "intermediary structure;" thereby converting the program from a self-redeeming system, to a "third-party marketing program that provides full compensation for 'free' stays offered to members." (Opinion ¶¶ 12, 21) There is no evidence that Marriott Rewards is a third-party vendor. This Court has found a third-party vendor relationships only where the participating vendee does not pay for, or otherwise incur, the costs of providing the rewards to the customers upon redemption of points. *See State Tax Comm'n v. Ryan-Evans Drug Stores*, 89 Ariz. 18, 21–22 (1960) (marketing company was a third-party vendor because the taxpayer-retailer did not itself provide premiums).

Second, the Opinion attempts to distinguish *Consumers Market* by stating the TPT at issue in *Consumers Market* was assessed under a different classification (retail) than the transient lodging classification at issue here. (Opinion ¶¶17-18) However, both classifications arise under the same statutory scheme, taxing business activities based on gross proceeds of sales or gross income. *See* A.R.S. § 42-5008(A). The TPT statutes make no distinction across classifications other than to explain which business activities are subject to the tax; thus, it was improper for the

Opinion to use classifications as basis to impose double taxation.

Third, the Opinion states that there is no evidence to show that the hotel marked up the price of its lodging to pay for the price of the "free" rooms earned by Members. (Opinion ¶ 22) In *Consumers Market*, the costs of the rewards program were reflected in the price of groceries, but there is no mention of a required "markup" in the decision. Here, just as in *Consumers Market*, Dove Mountain includes the costs of the program in its costs for lodging. Nevertheless, as the Dissent states, whether Dove Mountain upcharges the cost of its rooms to account for the program, or impounds a portion of post-tax revenues, "[t]he critical fact is that funds used to cover the costs of providing customers' premiums through their respective loyalty programs have already been subjected to taxation." (Dissent ¶37) If the Opinion stands, every businesses will now be *required* to show they up charged their customers to avoid double taxation. Such a result is counterintuitive to the purpose of the program; which is to reward customers for their repeat business, not increase prices.

Under *Consumers Market*, for close to 70 years, Arizona has not taxed reward redemptions, so long as tax is paid on the transactions generating the points (or other scrip) and the taxpayer is a self-redeemer of rewards. It is undisputed that Dove Mountain pays lodging TPT on lodging generating reward points and provides free lodging to Members. Thus, the Opinion's departure from this Court's long-standing

precedent of not taxing redemptions is unwarranted and should be reversed.

### C. This Case Provides A Good Vehicle For Determining Whether A Rewards Program Is Subject to TPT

In accordance with ARCAP 23(d)(3), this case provides a good vehicle to address important issues of law concerning taxation of loyalty programs that have been incorrectly decided. The relevant facts are not disputed and have broad application to other loyalty programs, across multiple industries; the factually record has been fully developed based on comprehensive stipulation of facts; the issues before the court require an interpretation of law; and the parties filed cross-motions for summary judgment. As such, this Court should review and reverse the Opinion, restoring the transaction privilege tax to its proper purpose and function.

## REQUEST FOR ATTORNEYS' FEES

Appellants respectfully request an award of attorneys' fees, costs, and expenses pursuant to ARCAP 21 and A.R.S. § 12-348.

## CONCLUSION

The Court of Appeals' decision (which held that Dove Mountain's rewards program is taxable) stands in tension with this Court's decision in *Consumer Markets* (which held that a grocery store's rewards program is not taxable). As shown by the Dissent, there is significant doubt as to whether the Court of Appeals' decision is correct. Regardless of whether the Court of Appeals' decision is correct, though, the tension between this decision and *Consumer Markets* creates significant uncertainty

over whether a given rewards program is taxable. This case, which presents a pure question of law with no factual disputes, provides a good vehicle to determine whether a rewards program is subject to TPT and to provide certainty to the many taxpayers that operate loyalty rewards programs.

RESPECTFULLY SUBMITTED this 10th day of July, 2023

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