# 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. CV-23-0176-PR<br><br>Court of Appeals Division One Case No. 1 CA-TX 22-0003<br><br>Maricopa County Superior Court Case No. TX2019-000448 |

# PLAINTIFF/APPELLANT SUPPLEMENTAL BRIEF


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## I. Introduction

Dove Mountain Hotelco, LLC and HSL Cottonwood RC Hotel, LLC ("Dove Mountain Hotel") submits this Supplemental Brief in support of its Petition for Review. This Court should vacate the Court of Appeals majority opinion because it causes taxpayers, i.e., Dove Mountain (and by extension its guests), to be taxed twice on the same transaction. It is settled law in Arizona that the State cannot impose transaction privilege tax on the transaction to earn a loyalty program reward and then again impose an additional tax when the reward is redeemed. *See State Tax Comm'n v. Consumers Mkt.,* 87 Ariz. 376, 379, 351 P.2d 654, 656 (1960). While rewards programs may have evolved since *Consumers Market*, this Court's decision in 1960 continues to ring true and control this case—the redemption of a reward is not a taxable event in Arizona, so long as tax is paid on the activity earning the reward. Whether in the form of trading stamps or points, the redemption of a reward is not a taxable event because the "imposition of a tax on the latter [redemption of the reward] would amount to double taxation." *Id.*

The Court of Appeals erred by transmuting post-tax funds reserved for the cost of future rewards into new, taxable income. *Consumers Market* instructs that reward redemption is not a sale and does not result in gross income under the state's transaction privilege tax. *87 Ariz. 376, 379, 351, P.2d 654, 656 (1960)*. The Court of Appeals also erred when it equated Dove Mountain's 4.5% remittance to the

Marriott rewards program as a payment for membership to a third-party vendor. As recognized by the dissent in the Court of Appeals, these contributions were not payments for membership, but funds set aside with a related program administrator, created for the singular, expressed purpose of administering the rewards program for the participating hotels, including the accounting and return of post-tax funds to the participating hotels, such as Dove Mountain, when guests redeem their earned rewards for lodging.

## II. Arizona's Canons of Statutory Construction Support Dove Mountain's Position

At its core, this case involves a question of statutory construction. The transaction privilege tax statute imposes a tax "measured by the amount or volume of business transacted by" a business and the tax is on the business' "gross proceeds of sales or gross income" within several different classifications. A.R.S. § 42-5008. The specific issue in this case is whether certain Reimbursements[1] are gross income within the scope of Arizona's transaction privilege tax transient lodging classification (A.R.S. § 42-5070).

In construing the scope of a taxing statute, rather than the scope of an exemption from the taxing statute, the statute must be construed in favor of the taxpayer and against the Department. *Ariz. Tax Comm'n v. Dairy & Consumers*

[1] Index of Record ("I.R.") 35, at 6:8-10, defining "Reimbursement".

*Coop. Ass'n*, 70 Ariz. 7, 18 (1950) ("statutes imposing taxes will be most strongly construed against the government and in favor of the taxpayer or citizen."). As this case involves the scope of a taxing statute rather than a scope of an exemption, the Court must construe any uncertainty in favor of Dove Mountain.

## III. In *Consumers Market*, this Court held that a redemption pursuant to a rewards program is not a sale and does not result in gross income for purposes of transaction privilege tax.

For more than 60 years, this Court's decision in *Consumers Market* has guided taxpayers offering loyalty rewards programs to their customers as to the taxability of program rewards. While the popularity and size of rewards programs have grown since *Consumers Market*, the programs remain fundamentally unchanged. As characterized by this Court, rewards programs are a system of "advanced spending and deferred enjoyment." *Consumers Mkt.*, 87 Ariz. at 379. The price for the item or service purchased today and the future reward are bundled together, and the tax the customer pays now, or over a series of purchases, covers the tax due on the future reward.[2] While rewards programs have progressed from physical stamps placed in a book to electronic points, this is how loyalty programs have always worked and continue to work today.

[2] The points, stamps, etc. provided by rewards programs represent a right to obtain merchandise in the future for "free" or at a substantial discount, and the tax due on the free or discounted item is added to the charge made for the items sold in the regular course of business generating the points, stamps, or other script. *Consumers Mkt.*, 87 Ariz. at 379 ("[h]ence plaintiff's gross proceeds from its retail sales … reflected the cost of retailing this merchandise [the rewards]. Thus, the 'consideration' referred to in the Act has already been paid by plaintiff's customers.").

In *Consumers Market*, the Court was tasked with determining whether a reward redeemed under a supermarket's reward program was subject to transaction privilege tax. The taxpayer in *Consumers Market* operated several supermarkets in Arizona. *Consumers Mkt.*, 87 Ariz. at 377. The taxpayer offered its shopping customers a loyalty marketing program, where customers earned trading stamps on purchases. The stamps could be accumulated by customers and redeemed for free merchandise. *Id.* The taxpayer provided the stamps and redeemed the stamps for rewards. The value of the "free" merchandise exchanged for trading stamps was included in the charges of items sold in the regular course of the taxpayer's business. *Id* at 378.

The Department argued in *Consumers Market* that Arizona privilege tax was due both on the sales generating the stamps, and on the value of the rewards given as premiums to customers upon trading stamp redemption. *Id.* In support of its position, the Department maintained that the redemption was a separate, taxable transaction and that the consideration exchanged for the rewards given were the stamps.

The taxpayer argued that any Arizona taxes due on the rewards exchanged for trading stamps were paid at the time the stamps were earned, since the value of the rewards were included in the sales generating the stamps, and therefore previously included in taxpayer's gross income subject to Arizona tax. *Id.*

This Court held in *Consumers Market* that, as a matter of statutory construction, no tax was due on the redemption of the reward. *Id*. at 379-380. The Court reasoned that because the value of the reward (free merchandise) is included in the sales generating the trading stamps, the tax due on the value of the rewards merchandise had been captured, and paid for by its customers, at the time of the retail sale. *Id*. The Court explained that "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 [taxpayer's] customers." *Id.* at 379. The Court also noted that imposing tax on a reward redemption would result in "double taxation," contrary to legislative intent. *Id.* at 380. Thus, the Court concluded there is no taxable event when a customer redeems a reward. *Id.; see also State Tax Comm'n v. Ryan-Evans Drug Stores*, 89 Ariz. 18, 21–22 (1960) ("Arizona does not tax the redemption transaction, as most other states imposing a sales tax do....").

## IV. This case is materially indistinguishable from *Consumers Market*. Therefore, just as in *Consumers Market*, the rewards transactions in this case are not taxable.

For purposes of the transaction privilege tax, the Rewards Program[3] at issue in this case is indistinguishable from the rewards program in *Consumers Market*. Dove Mountain participates in a loyalty program that provides rewards to repeat

[3] I.R. 35, at 4:22-23, defining "Rewards Program."

customers, just like the stores in *Consumers Market*. Just as in *Consumers Market*, Dove Mountain remits tax on the initial purchases on which its customers accrue rewards value. Just as in *Consumers Market*, Dove Mountain includes the cost of the rewards (the free lodging) in the lodging prices the hotel charges all guests for hotel stays. (I.R. 35, at 5:24-25; I.R. 37, at 2:14-16, referencing Escorza Decl. ¶ 9). And, just as in *Consumers Market*, Dove Mountain's customers can redeem their rewards without further charge. Therefore, just as in *Consumers Market*, Dove Mountain's reward redemptions are not sales generating gross income and are not taxable.

The Appellate Court majority points to three factual differences between this case and *Consumers Market* to justify taxing Dove Mountain's Reimbursements, but these differences cannot carry the weight that the Appellate Court places on them. These perceived factual differences are either unsupported by the record or rely on legal analysis foreclosed by this Court in *Consumers Market.*

First, the Appellate Court purported to distinguish this case from *Consumers Market* on the grounds that Dove Mountain's payments to Marriott Rewards LLC were membership fees, and that the rewards redemptions were not the return of capital but additional gross income to Dove Mountain. This factual conclusion is not supported by the record. (I.R. 35, at 6:16-19, 10:12-16, and 12:4-23; I.R. 37, ¶¶ 4-11.) The record in this case shows that Dove Mountain contributed capital (post-

tax funds) to Marriott Rewards LLC which was subsequently returned when customers redeemed rewards. (I.R. 35, at 5:10-23; 6:8-21; I.R. 37, at 2:10-3:10.) Additionally, Dove Mountain's agreement with Marriott Rewards LLC establishes that (1) the Contribution payments[4] are to be returned to the participating hotels if the program ever terminated; (2) it is understood that the Contribution payments will be returned in part to the participating hotels in the forms of Reimbursements; and (3) the "free" lodging rewards (like the free merchandise in *Consumers Market*) have a cost, and the hotels account for the costs of the future rewards using the post-tax monies received from Program members by making Contribution payments to the Rewards Program. (I.R. 36, at 3:12-5:11, citing Exhibit D.) Thus, as the Contribution payments are to pay for future rewards, and the reward redemptions are a return of Dove Mountain's post-tax capital, the Reimbursements cannot be additional gross income.[5]

Second, the Appellate Court asserted that the taxpayer in *Consumers Market* "marked up" the cost of its merchandise to account for the future costs of the rewards

[4] I.R. 35, at 5:16, defining "Contribution payments."

[5] As explained above, the record in this case clearly establishes that the reward redemptions are a return of Dove Mountain's capital rather than additional gross income. Dove Mountain paid tax on the monies contributed to Marriott Rewards, and has limited its refunds to reimbursements equal to or less than its contributions. In other words, Dove Mountain's refund is limited to the Contributions it made into the Rewards program. (I.R. 35, at 7:15-8:3; *see also* Appellant's Opening Brief, at 12-13; 24.) However, to the extent that the Department disputes this point, because this case was decided on summary judgment the court must "view[] the facts in the light most favorable to" the non-moving party. *S. Point Energy Ctr. LLC v. Ariz. Dep't of Rev.*, 253 Ariz. 30, 33 (2022).

provided to its reward program members, and that this was unlike Dove Mountain's fact pattern. (Opinion ¶¶ 17, 22.) This analysis is flawed. *Consumers Market* states only that the cost of the rewards resulted in "higher prices" of "foodstuffs" charged to all customers, not that the taxpayer charged a specific markup to its customers to account for the rewards. *Consumers Market*, 87 Ariz. 376, *379. This is no different from how Dove Mountain includes the cost of the rewards in its lodging prices, which, like any other cost or expense incurred by the hotel, results in higher prices. (I.R. 35, at 5:24-25, referencing Escorza Decl. ¶ 9 ("Dove Mountain treats the contribution amount paid to the Rewards Program as a cost of doing business and like all costs and expenses, this expense is reflected in the prices charged to all guests for lodging."))

Third, the Appellate Court distinguished this case on the grounds that Dove Mountain uses Marriott Rewards LLC as a program administrator. However, Dove Mountain's use of a program administrator does not impact the conclusion in *Consumers Market* that there is no sale or new taxable gross income when a customer redeems an award. The legal reasoning in *Consumers Market* is unchanged by whether the taxpayer administered its rewards program or a third-party administered the rewards program. Although *Consumers Market* presumably

involved a self-administered rewards program, its construction of the transaction privilege tax statute is unrelated to those precise facts.[6]

## V. Marriott's Rewards Program is not like a manufacturer's coupon

The Department avers that "Arizona treats 'points'-type reward/consumer loyalty programs such as the Rewards Program like it treats coupons." (Dep't Resp. to Pet. for Rev., p. 11.) The Department fails to cite to any authority for comparing reward programs to coupons and does not attempt to explain how reward programs and coupons are similar. Perhaps this is because Arizona's coupon regulation (Ariz. Admin. Code R15-5-129), does not address or otherwise incorporate reward programs.

Additionally, the Department's attempt to analogize the Rewards Program to coupons omits a critical difference between the two. Coupons are not issued for consideration, whereas the reward points and the associated rewards were *earned by*

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[6] In *Ryan-Evans*, decided the same year as *Consumers Market*, the Court held that the taxpayer could not deduct the cost of stamps provided pursuant to a rewards program administered by a third-party because they were not a cash discount or deductible business expense. 89 Ariz. at 22-23. A material distinction between *Consumers Market* and *Ryan-Evans*, is that Consumers Market paid sales tax on the total amount of its gross sales and took no deduction (cash discount) for the cost of the trading stamps provided to its customers. *Id.* at 21. Whereas Ryan-Evans claimed the cost of the stamps as a cash discount and deducted the cost of the stamps from its gross receipts. Another distinction between the two cases is that in *Ryan-Evans*, the entity making the sales generating the stamps (Ryan-Evans) was not the same entity redeeming the stamps for rewards (Sperry & Hutchinson Company). Thus, under *Ryan-Evans*, transaction privilege tax could be owed on the sale generating the points and a separate use tax could be due on the rewards provided by the redeemer, because there were two different taxpayers and therefore no double taxation. Here, just like Consumers Market, Dove Mountain did not deduct the cost of the cost of the points awarded from transaction privilege tax, and Dove Mountain is both the seller and the rewards redeemer.

*the Rewards Program members* by making prior purchases. Thus, the Department's coupon analogy is inapt.

Marriott Rewards LLC also does not redeem the points or provide consideration to Dove Mountain for free lodging. Dove Mountain redeems the rewards by providing free lodging and the consideration for the free lodging is paid by the customer when the points *are earned*.

## VI. The Court should stand by its decision in *Consumers Market*

As explained above, this case is indistinguishable from *Consumers Market*. Dove Mountain offers a loyalty program that provides rewards to repeat customers, just like in *Consumers Market*. There is no reason to deviate from the analysis in *Consumers Market* in this case. *Consumers Market* correctly decided that, under Arizona's transaction privilege tax statute, a reward redemption by a customer in exchange for a free product is not taxable. The transaction privilege tax "is a tax upon the privilege of engaging in business measured by the gross income from sales." *Consumers Market*, 87 Ariz. at 379; *accord* A.R.S. § 42-5008. A rewards program such as Dove Mountain's is "a system of advanced spending and deferred enjoyment," which means that a rewards redemption is not a sale and is not within the intended scope of the transaction privilege tax. *Consumers Market*, 87 Ariz. at 379–80. Any other result would cause double taxation: tax would first be imposed on the advanced spending (i.e., when the customer spends money at Dove

Mountain), and would then be imposed again on the deferred enjoyment, with no additional payment by the customer (i.e., when the customer redeems the reward at Dove Mountain). *Id*. at 380.

The conclusion that *Consumers Market* correctly construed the transaction privilege tax statute should be beyond reproach. The Department itself has repeatedly—and favorably—cited *Consumers Market* in other matters. *See, e.g., Arizona Dep't of Rev. v. Daniel*, 189 Ariz. 13, 12 (Ariz. Ct. App. 1996) (Department cited *Consumers Market* for "the proposition that bingo players who obtain bingo paper purchase only the right to play the game"); Arizona Department of Revenue, Private Taxpayer Ruling No. LR11-009 (June 14, 2011) (citing *Consumers Market* for the proposition that the transaction privilege tax "is a tax on the privilege of engaging in business as measured by the gross income from all of its sales, rather than a tax on the sale of goods."). *Consumers Market's* analysis is also consistent with the New York Division of Tax Appeals' decision addressing the tax treatment of Marriott's rewards program.[7]

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[7] *See In re Marriott Int'l, Inc., NY Div. of Tax Appeals*, Tax DTA Case No. 821078 *et seq*. (Jan. 14, 2010) https://www.dta.ny.gov/pdf/archive/Decisions/821078.dec.pdf.
*See also* Fla. Tax Info. Pub. No. 06(A)01-01, 03/17/2006 ("Because tax on room charges has previously been paid on the funds contributed to the central program fund, no tax is due when a participating hotel contributes more to the fund in any given month than it receives in reimbursements for that same month."); Ill. Dep't of Rev. Ltr. Rul. 13-0043-GIL, 8/23/2013 (hotels are not generally subject to tax on reimbursements paid from a separate, central fund established to administer a hotel's loyalty program); Texas Policy Ltr. Rul. No. 200405570L, 05/10/2004 ("[f]or reimbursements to not be taxable, hotel records must show that the hotel had paid the rewards fund at least an amount equal to a specific month's reimbursement, as well as

In an attempt to discredit *Consumers Market*, the Department has asserted that the South Dakota Supreme Court held that "revenue from [a] rewards program for cost of guest's room is taxable." (Dep't Resp. to Pet. for Rev., at 14, citing *Choice Hotels Int'l, Inc. v. S.D. Dep't of Rev. & Regulation*., 711 N.W.2d 926, 930 (S.D.)). Unfortunately for the Department, the South Dakota Supreme Court did no such thing in *Choice Hotels*. The *Choice Hotels* case does not address the tax treatment of a rewards redemption. *Choice Hotels* held that the fees a hotel franchisor received from its franchisees in exchange for administering a rewards program are taxable services.[8] 711 N.W.2d at 930. Thus, this decision has no bearing on the tax treatment of reward redemptions, which is a completely different transaction.[9]

Even if the Court were to harbor some doubt about whether *Consumers Market* was correctly decided, stare decisis considerations would weigh strongly against overruling or limiting *Consumers Market*. Stare decisis "cautions courts against overruling a prior opinion unless the reasons underlying" the prior opinion "no longer exist or the opinion was clearly erroneous or manifestly wrong."

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administrative charges, prior to receiving the reimbursement."); Va. Pub. Doc. Rul., No. 07-12, 03/23/2007 ("the money contributed to the Fund was taxed upon receipt from the hotels' customers. The hotels are merely receiving back the money contributed to the Fund following a qualifying sale.")

[8] South Dakota imposes its retail sale and service tax on business services. S.D. Codified Laws § 10-45-4. Arizona does not have a comparable transaction privilege tax on business services. Ariz. Rev. Stat. §§ 42-5061-42-5076.

[9] The other state letter rulings and guidance cited by the Department are also not on point because the cited materials only discuss reward programs in general, and do not either address programs similar to Marriott's Rewards Program, or Reimbursements, specifically.

*Laurence v. Salt River Project Agric. & Improvement Power Dist.*, 528 P.3d 139, 144 (Ariz. 2023) (internal quotations omitted). The threshold for abandoning a prior opinion that construes a statute (as opposed to the state constitution or common law) is even higher since the prior opinion effectively "becomes part of the statute." *Galloway v. Vanderpool*, 205 Ariz. 252, 256 (Ariz. 2003); see also Supplemental Brief of Arizona Department of Revenue and Mohave County, *South Point Energy Ctr. LLC v. Arizona Dep't of Rev.*, CV-21-0130-PR, 2022 AZ S. CT. BRIEFS LEXIS 68 (Jan. 18, 2022) ("If courts could discover new meanings in old statutes, they would risk upsetting reliance interests in the settled meaning of a statute.") (internal quotations omitted).

*Consumers Market* construed the transaction privilege tax statute, so the decision in that case is entitled to heightened stare decisis. As the legislature has not amended the statute in a way that "changes the court's interpretation," the Court must "presume the legislature approved of the court's construction" of the transaction privilege tax statute in *Consumers Market*. *Galloway*, 205 Ariz. at 256.

Furthermore, departing from *Consumers Market's* analysis in this case would directly undermine the reliance interests of businesses with rewards programs and would risk injecting unnecessary uncertainty into Arizona's tax system beyond the narrow bounds of this case. Rewards programs such as Dove Mountain's are a common business practice in the travel and hospitality industries, and businesses in

this space (as well as others) must consider the tax treatment of rewards in establishing the rewards program and setting pricing. A decision casting doubt on *Consumers Market* would disrupt the interests of businesses that have relied on *Consumers Market* in making decisions regarding rewards programs. Such a decision could also have knock-on effects on other areas of Arizona tax jurisprudence. A body of law has grown around *Consumers Market* over the past sixty years, and, in particular, on its holding that transaction privilege tax "is a tax upon the privilege of engaging in business measured by the gross income from sales." *Consumers Mkt.*, 87 Ariz. at 379; *see Daniel*, 189 Ariz. 13, 16 (Ariz. Ct. App. 1996) (relying on *Consumers Market* to conclude that bingo paper sales were exempt as sales for resale); *State Tax Comm'n v. Ranchers Exploration & Dev. Corp.*, 528 P.2d 866 (Ariz. Ct. App. 1974) (relying on *Consumers Market* to conclude that tax is due on transfer of copper cathodes); *Stapley v. Arizona Dep't of Rev.*, No. 994-92-U(6) (Ariz. Board of Tax Appeals July 13, 1993) (relying on *Consumers Market* to conclude that tax is not due on toys awarded at arcade). Overruling or limiting *Consumers Market* would thus require taxpayers, the Department, and the courts to expend considerable resources to reevaluate this body of law.

There is no good reason for the Court to depart from *Consumers Market* in this case. *Consumers Market* was correctly decided. Even if the Court were to

disagree with the statutory construction in *Consumers Market*, stare decisis considerations weigh strongly against deviating from that decision. Finally, the negative practical burdens that would result from overruling or modifying *Consumers Market* cannot be justified by the state's incremental benefit from collecting additional revenue on Dove Mountain's rewards program. Therefore, the Court should simply apply *Consumers Market* in this case.

## VII. Conclusion

Because Dove Mountain paid transaction privilege tax on the point-earning activities (i.e., lodging), and is a self-redeemer of the rewards at issue, the point redemption is not considered a sale or gross income under Arizona tax law, and the Reimbursements are not subject to Arizona privilege tax. There is no sale or consideration exchanged or due at the time of point redemption. The sale and consideration exchanged for the "free" lodging (or other reward) is paid for by the members when the points are earned. The original purchase includes both the item purchased (current lodging) and the value of the future reward (future lodging), and any tax due is paid for at that time. This case is analogous to and controlled by this Court's decision in *Consumers Market*, and the Court should respectfully find that the redemption of points for rewards and the Reimbursements are not subject to Arizona transaction privilege tax.

RESPECTFULLY SUBMITTED this 5th day of December, 2023

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