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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2010-001089 06/16/2014

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

SABAN RENT-A-CAR L L C, et al. SHAWN K AIKEN

v.

ARIZONA DEPARTMENT OF REVENUE, et al. KIMBERLY J CYGAN

TIMOTHY BERG
WILLIAM H KNIGHT
KEVIN M GREEN

UNDER ADVISEMENT RULING

Following oral argument on May 7, 2014, the Court took Defendant and Defendant-Intervenor's Motion for Summary Judgment and Plaintiffs' Cross-Motion for Summary Judgment under advisement. Additionally, following the oral argument on May 7, 2014, the Court has read and considered Plaintiffs' Supplemental Citation of Legal Authorities Addressing Points Raised During Oral Argument on May 7, 2014, Defendants' Objections to Plaintiffs' Supplemental Citation of Authorities filed May 13, 2014, and Plaintiffs' Reply thereto filed May 27, 2014.

This matter involves a challenge to a tax as unconstitutional under provisions of both the state and federal constitutions.

The Court begins by determining how the Arizona Sports and Tourism Authority (AzSTA) "tax," which A.R.S. § 5-839(A) calls a "car rental surcharge," is to be categorized. Broadly, it is an excise tax. *Gila Meat Co. v. State*, 35 Ariz. 194, 197 (1929); *Arizona Farm Bureau Federation v. Brewer*, 226 Ariz. 16 ¶ 36 (App. 2010). More specifically, the Court of Appeals described it as "akin to" a transaction privilege tax, "more similar to [a] transaction privilege tax[] than to [a] sales tax[]." *Karbal v. Arizona Dept. of Revenue*, 215 Ariz. 114, 116 ¶ 9 and section A heading (App. 2007). It is a tax on the business activity of renting cars, *id.* at 116 ¶ 10. However, it is a tax of a very peculiar kind, because, although the surcharge falls on the business, the amount of the surcharge depends on the customer's reason for renting the car.

A.R.S. § 5-839(B)(1) sets the rate at 3¼ percent of the gross proceeds with a $2.50 minimum; however, subsection 2 sets it at a fixed $2.50 if the vehicle is intended as "a temporary replacement motor vehicle" if the vehicle it is replacing is lost or under repair. (Arithmetically, the rates diverge when the total charge reaches approximately $77.00.) The Court is not familiar with any other statute taxing the privilege of conducting identical transactions differently based solely on the customer's reason for entering into them, which may explain the equivocal language used by the Court of Appeals. *Karbal* was decided on the narrow ground that the plaintiff lacked standing, and did not examine whether the tax contravenes the Arizona Constitution or the Interstate Commerce Clause. It also did not address whether, and if so on what ground, the business may challenge the tax, though it cited *Oklahoma Tax Comm. v. Chickasaw Nation*, 515 U.S. 450, 461-62 (1995), to the effect that it may.

There is some basis, both in the statutory text and in the legislative history,[1] for treating the AzSTA tax as an amalgamation of two distinct taxes. Prior to its enactment, there was a flat $2.50 tax on all car rental transactions, with the proceeds going to the Maricopa County Stadium District. A.R.S. § 5-839(G) preserves the Stadium District's entitlement to the first $2.50 of each rental, with the remainder of the 3¼ percent surcharge distributed to AzSTA. The official publicity pamphlet, at page 4, also distinguished between the Stadium District and AzSTA portions. The surcharge can therefore be seen as a $2.50 Stadium District tax on all car rental transactions and a 3¼ percent minus $2.50 AzSTA tax on car rental transactions not involving temporary replacement. However, while this may be conceptually neater – two taxes each at a fixed rate with only one dependent on the customer's motivation as against one tax at a variable rate dependent on the customer's motivation – it does not affect the legal analysis, and there is no statutory authorization to sever the AzSTA portion from the Stadium District portion should that be necessary.

"[T]he methodology whenever a right that the Arizona Constitution guarantees is in question [is to] first consult our constitution." *Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm.*, 160 Ariz. 350, 356 (1989). Article 9 § 14 of the Arizona Constitution requires that "[n]o moneys derived from fees, excises, or license taxes relating to registration, operation, or use of vehicles on the public highways or streets" be used for any but specified highway-related purposes. As has been seen, the AzSTA surcharge is an excise; *Gila Meat*, *supra*. The clause therefore applies to it. The Department does not argue that the rental of cars falls outside the scope of the constitutional provision: not only does A.R.S. § 5-839(C) limit the surcharge to "the business of leasing or renting for less than one year motor vehicles for hire without a driver, that are designed to *operate on the streets and highways of this state*" (emphasis added), but obviously no customer would go to the trouble and expense of renting a car only to leave it in the

[1] Voter pamphlets are relevant legislative history for measures enacted by the people. *Calik v. Kongable*, 195 Ariz. 496, 500 ¶ 17-18 (1999).

parking lot. Instead, it argues that, under Arizona law, the transaction privilege tax is levied, not on the sale of a good or service, but on the privilege of conducting such a sale. *Arizona State Tax Comm. v. Southwest Kenworth, Inc.*, 114 Ariz. 433, 436 (App. 1977). This argument fails for at least one and perhaps two reasons. The Court of Appeals in *Karbal*, *supra* at 116 ¶ 9, indicated that the AzSTA tax is neither a true transaction privilege tax nor a true sales tax, though more akin to the former; the general rule governing pure transaction privilege taxes thus may not apply to it. Even if it does, the Constitution restricts the use not only of taxes *on* vehicles, but of taxes *relating to* vehicles. The Arizona courts have not defined "relating to," either generally or in relation to this clause. But the constitutional language plainly includes more than just a tax whose incidence falls directly on the vehicle or its use. The required nexus between the motor vehicle and the tax is that some relationship exists to connect them. The case law holding that transaction privilege tax is a tax not on the underlying sale but on the right to conduct the transaction does not hold that the tax is unrelated to the underlying sale. Here, indeed, the distinction falls apart: the class of taxable transactions is defined by the relationship of those transactions to the rental of cars. That the AzSTA tax relates to the use of vehicles on the public highways or streets is plain. Its receipts may therefore be applied only to one or more of the purposes set down by the Constitution. The construction and maintenance of athletic facilities is not among those purposes.

Turning to the federal constitutional challenge, and beginning with the standing of these plaintiffs to bring it although the tax does not discriminate against them, the Court begins with the proposition that an unconstitutional tax is an illegal tax, and that its collection is consequently illegal. A.R.S. § 42-11005(A) allows an action to recover an illegally collected tax. Such a suit can be maintained only by the taxpayer; that the customer does not pay a transaction privilege tax was the rationale of *Karbal*, *supra* at 116-17 ¶ 11. But the statute does not limit the taxpayer's right to recover to those taxes whose illegality is targeted at him personally. The Department's argument to the contrary would create, where a tax is targeted at one group but collected from another, a transaction privilege tax exception to the commerce clause.[2] On a more general level, in Arizona law, standing may be found when there exists a "distinct and palpable injury" to the plaintiff. *Sears v. Hull*, 192 Ariz. 65, 69 ¶ 16 (1998). There is enough in the record to reach that threshold. In addition, standing can be waived in exceptional circumstances. Such cases must be ones involving issues of great public importance that are likely to recur, *id.* at 71 ¶ 25, and in which the parties are able to sharpen the legal issues presented, *id.* at 71 ¶ 24. The Court has no hesitation in finding that the AzSTA surcharge is indeed an issue of great public importance and that the parties are fully capable of and motivated to present the legal issues (as confirmed by the heft of their briefing).

[2] Nor is it evident that the commerce clause is the only constitutional provision that could be circumvented. To take one possible example, a TPT on car rentals to racial minorities would surely be invalid under the equal protection clause even if the rental company paying the tax was not itself a racial minority.

To determine the extent to which the surcharge burdens customers from out of state over Arizona customers, the Court ordered additional development of the factual record. The results are, it must be said, surprising. The Court's initial impression was that the replacement-vehicle exemption would work in a discriminatory manner, favoring in-state residents over out-of-state residents with no rational basis to do so. Were that the case, the Court might very well have found the surcharge to violate the federal constitution. But in practice, the exemption from the surcharge does not seem to have made a significant difference simply because the car rental companies are charging the same rate to all customers regardless of their reason for renting. As Mr. Saban explained in his December 9, 2013 affidavit, the burden of proof the Department has placed on the companies is so onerous that to charge a customer the lower replacement-car rate and then document his entitlement to it would be prohibitively expensive. Thus, the Court is faced with the reverse of the typical commerce clause challenge: instead of a facially neutral tax being discriminatory as applied, the tax here is, at least arguably, facially non-neutral but applied in a nondiscriminatory manner.

The Court can find no support for the proposition that discriminatory intent standing alone violates the commerce clause. The Supreme Court has held that a finding of economic protectionism can be made on the basis of either discriminatory purpose or discriminatory effect. *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263, 270 (1984). But the surcharge is not protectionist in nature. It does not seek to deter or impede interstate commerce; on the contrary, the promise of palatial sports facilities can only be realized by maximizing the amount that can be extracted from visitors without keeping them away. Thus, the situation here differs from that in *South Dakota Farm Bureau, Inc. v. Hazeltine*, 340 F.3d 583 (8th Cir. 2003) (striking down constitutional provision excluding out-of-state corporations from owning farms), and *Waste Management Holdings, Inc. v. Gilmore*, 252 F.3d 316 (4th Cir. 2001) (striking down statute prohibiting importation of out-of-state garbage), both dealing with laws protectionist in nature. The Commerce Clause also prohibits taxing interstate commerce at a disproportionate rate with a consequent lack of relationship to services provided by the government. "A tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 289 n.15 (1977). This language does not suggest that a "tailored tax" is subject to strict scrutiny regardless of whether it produces any effect, but rather the opposite, that to invalidate such a law requires proof of discriminatory effect. Due to the manner in which the AzSTA surcharge is being applied in practice by the car rental companies, the Court cannot find in it a commerce clause violation. It is true that the formal incidence of the tax on the car rental companies rather than their customers does not insulate the tax from the purview of the commerce clause, provided that the customer pays indirectly. *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564, 580 (1997) (incidence of tax makes no analytic difference). But the Supreme Court in that case expressly found that the economic incidence of the tax fell at least in part on the out-of-state customers. *Id.* Here, that simply has not happened: the companies have imposed

the same tax on in-state and out-of-state renters, and on replacement-car and non-replacement car, customers alike. The economic incidence of the tax has fallen exclusively on the car rental companies, and its incidence on them raises no commerce clause issue. Perhaps recognizing the lack of discriminatory effect created by the surcharge, Plaintiffs belatedly raise a challenge to the tax on car rentals as a whole: because most car renters are from out of state, a tax on rental cars is discriminatory even without the differential rate for replacement cars. This would raise an entirely new issue requiring litigation from scratch. The Court does not believe it is appropriate at this late date. Nor does the Court find persuasive support for such an argument in relevant case law.

Nevertheless, the Court finds that A.R.S. § 5-839 violates Article 9 § 14 of the Arizona Constitution, in that it imposes an excise tax relating to registration, operation, or use of vehicles on the public highways or streets whose proceeds are applied to purposes not permitted by the constitutional text.

Accordingly,

IT IS ORDERED granting Plaintiffs' Cross-Motion for Summary Judgment.

IT IS FURTHER ORDERED denying Defendants' Motion for Summary Judgment.

IT IS FURTHER ORDERED directing Plaintiffs to lodge a form of judgment and file any Application and Affidavit for Attorney's Fees and Statement of Taxable Costs by July 18, 2014.