SUPREME COURT OF ARIZONA

CHURCH OF THE ISAIAH 58 PROJECT OF ARIZONA, INC., Appellant, v. LA PAZ COUNTY, ARIZONA; RICHARD OLDHAM and OLDHAM FAMILY TRUST; GEORGE NAULT, LA PAZ COUNTY ASSESSOR; and LEAH CASTRO, LA PAZ COUNTY TREASURER, Appellees.	Case No. Court of Appeals, Division One Case No. CA-TX 12-0001

PETITION FOR REVIEW TO THE ARIZONA SUPREME COURT

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PETITION FOR REVIEW

Appellant, Church of the Isaiah 58 Project of Arizona petitions the Supreme Court of Arizona to review the decision of the Court of Appeals in this matter.

Issues Presented for Review

1. Whether an injunction to restrain payment of taxes before challenging them as illegal is appropriate when a church is financially unable to pay taxes that have been assessed without semblance of authority and payment of such taxes would result in closure of the church and loss of its fundamental constitutional rights.

2. Whether an injunction to restrain payment of taxes is appropriate when a property tax assessor acts without semblance of authority by imposing taxes on a Church even though it is recognized by the State as an exempt non-profit.

Statement of Facts

This case is about a Church's right to exist and freely practice its religion on its own property in the face of a threat of foreclosure that stems from an illegal tax which the Church is financially unable to pay. The Church of the Isaiah 58 Project of Arizona is a small church located in Quartzsite, Arizona. (R1; p.2). The Church bought a piece of property in Quartzsite in August, 2006. (R1; p.3). It uses the property to conduct religious worship services, daily Bible study and various

outreach programs to the needy in the community. *Id*. The outreach programs consist of a feeding program during Winter months where the Church cooks and offers a free hot meal every day to the poor in the community. (R1; p.3). The Church also distributes food bags to those who need them in the community, operates a clothes closet where it distributes clothes to the needy, provides free job counseling and transportation to assist individuals in securing employment, and hosts various concerts and events that are open to the public. (R1; p.3-4).

On August 25, 2006, shortly after purchasing the property, the Church submitted its Articles of Incorporation to the La Paz County Assessor in the hopes of obtaining a property tax exemption. (R1; p.4-5, Exh. A). A representative of the Assessor's office told the Church that it would be required to pay taxes for 2006. (R1; p.5).[1]

On February 20, 2007, the Church submitted an Affidavit for Organizational Tax Exemption to the County Assessor as required by A.R.S. §42-11152(A)(1). (R1; p.5). The Assessor's office told the Church that its application for tax exemption was incomplete because it did not submit a letter from the Internal Revenue Service recognizing the Church as exempt from federal taxation under 26 U.S.C. §501(c)(3). *Id*. The Assessor sent the Church a letter setting forth the Assessor's policy requiring:

[1] The Church is not seeking review of the Assessor's decision, which was upheld by the Appeals Court, to impose taxes for 2006.

> The 'Letter of Determination' from the Internal Revenue Service, exempting your organization under I.R.C. 501.C.3. *This document is a prerequisite to the property tax exemption process*, (sic) a copy is needed to complete your application.

(R1; p.6, Exh. C) (emphasis added). Pastor Mike Hobby, the Pastor of the Church, informed the Assessor's office that churches were not required to have a letter of determination from the IRS to be considered exempt from federal income taxation and that the Church did not have such a letter and would not be obtaining one. (R1; p.6); s*ee generally* 26 U.S.C. §508(c)(1)(A) (churches are automatically exempt under federal law without a letter from the IRS).

The Assessor continued to communicate to the Church that he would not even consider the Church's property tax exemption application until he received a determination letter from the IRS. (R1; p.6, 7). Although the Assessor never denied the Church's application for a property tax exemption, he assessed the Church property taxes for 2007. (R1; p.6). On February 11, 2008, the Assessor placed a lien on the Church's property and the lien was purchased at a tax sale that same day. (R1; p.7, Exh. D). The Church was never notified of these actions until the La Paz County Treasurer sent a letter to the Church on February 13, 2008, that a tax lien had been placed on its property and that, if not redeemed, a treasurer's deed could be issued to the holder of the lien. (R1; p.7, Exh. E). The Assessor also later assessed property taxes against the Church for 2008 and 2009 and added the amount to the tax lien, thus making the Church liable for taxes for 2007, 2008, and

2009. (R1; p.7). The taxes were assessed even though the Church's application for property tax exemption had never been formally denied by the Assessor and the Church had not received any official notice of these actions until late February of 2008.

In June, 2009, the Church was able to obtain a letter from the Arizona Department of Revenue that confirmed the tax exempt status of the Church under Arizona law. (R1; 7, Exh. F). The letter stated:

> This letter is in response to your request for confirmation of the tax-exempt status of the Church of the Isaiah 58 Project of Arizona, Inc. After review of your request for tax exempt status, we have determined that the Church of the Isaiah 58 Project of Arizona, Inc. is exempt from Arizona income tax under Arizona Revised Statutes (A.R.S.) §43-1201.4. ***Further, as a church exempt under this section, property used or held primarily for religious worship is exempt from property tax under A.R.S. §42-11109A.***
> …
> ***The tax exempt status granted by this letter is effective from and after August 24, 2006.***

Id. (emphasis supplied).

Pastor Hobby submitted the letter to the Assessor. (R1; 8). On August 14, 2009, the Assessor sent a letter granting the Church a property tax exemption for the Church's property for tax year 2009 only. *Id*. Inexplicably, the Assessor refused to grant a property tax exemption to the Church for tax years 2007 and 2008 thus leaving the tax lien on the Church's property intact. The only reason the Assessor refused to grant a tax exemption for 2007 through 2008 is because of the policy that a letter of determination from the IRS is a prerequisite for property tax

exemption for a Church. (R1; 8).

As of the time of the filing of this lawsuit, the amount of taxes owed by the Church exceeded $52,000.00. (R1; p.9). The lienholder attempted to foreclose on the Church's property, but was prevented from doing so because of the entry of an injunction by the Tax Court prohibiting foreclosure while the case is pending. (R1; p.9) (R24).

The Church is a small church and is financially unable to pay the taxes imposed on it by the Assessor. (R1; p.9). If it is required to pay the taxes assessed against it, the Church will be forced to close and to cease its religious worship activities at the property, including its worship services and its ministry outreach to the poor in the community. *Id*.

After the Church filed this action, Defendant La Paz County filed a motion to dismiss Plaintiff's Complaint. (R25). On August 9, 2011, the Tax Court entered an Order dismissing Plaintiff's Complaint. (R35). In its Order, the Tax Court held that the Church's action should be dismissed because the Church had not yet paid the taxes that were assessed. (R35; p.1).[2]

The Church appealed to the Arizona Court of Appeals. The Appeals Court issued its opinion on September 12, 2013, affirming the Tax Court's Order dismissing the Church's Complaint. The Appeals Court opinion, attached hereto,

[2] In its final judgment, the Tax Court continued the preliminary injunction pending the outcome of any appeals in this case. (R42; p.2).

dismissed the claims for injunctive and declaratory relief raised by the Church because it held that the Church was required to first pay the taxes owed before it could challenge those taxes as illegally assessed. In its opinion, the Appeals Court construed this Court's precedent and held that actions by taxing authorities that were without semblance of authority were those that amount to "legal fraud or the equivalent." Appeals Court Op. at 15. The court held that the Assessor's policy of requiring an IRS letter as a prerequisite to a church property tax exemption was "wrong" and "inconsistent with recognized statutory options for proving tax-exempt status." *Id*. at 16. But then it held, with no explanation or rationale, that the imposition of taxes was not done without semblance of authority. *Id*. at 17. Thus, it affirmed dismissal of the Church's injunctive claims.

The Supreme Court should review this decision for the reasons stated below.

Reasons for Granting this Petition

I. This Court should decide the important issue of law that equitable relief is proper when loss of fundamental constitutional rights will occur by requiring payment of taxes prior to challenging the taxes as illegal.

As discussed below, this Court held on several occasions that a taxpayer may seek an injunction to restrain the collection of an illegal tax. Because an injunction is an equitable remedy, this Court has required a showing in such cases by a taxpayer that an adequate remedy at law does not exist before enjoining the illegal tax. *See Crane*, 163 P.2d at 665 (stating: "Unless the tax is enjoined the

result will be a multiplicity of suits, and, therefore, the remedy at law is inadequate."); *Lane*, 236 P.2d at 461 (denying injunction because payment of tax was "insignificant" and thus taxpayer had adequate remedy at law).

This Court has not construed when an adequate remedy at law is lacking such that an injunction is appropriate. In this case, this important issue of law should be decided given the fundamental constitutional rights of the Church to freely exercise its religion.[3]

The Church has alleged in its Complaint, which must be taken as true, that it cannot pay the taxes assessed against it and that payment of the taxes would require it to close the Church and forego its constitutionally-protected activities. Indeed, the United States Supreme Court has stated that religious worship is a "form[]of speech and association protected by the First Amendment." *Widmar v. Vincent*, 454 U.S. 263, 269 (1981); *see also Murdock v. Pennsylvania*, 319 U.S. 105, 109 (noting that worship in churches and preaching from the pulpit occupies a "high estate under the First Amendment."). The United States Supreme Court has also held that the "loss of First Amendment freedoms, for even minimal periods of time, unquestionably constitutes irreparable injury." *Elrod v. Burns*, 427 U.S. 347, 373 (1976).

Because the Church stands to lose the right to exercise its First Amendment

[3] The Appeals Court did not consider this issue since it held that the Assessor acted with semblance of authority. *See* Appeals Court Op. at 17n.8.

freedoms, it unquestionably is facing irreparable injury if it is required to pay the taxes prior to challenging them as illegal. These constitutional rights stand at the zenith of First Amendment protection and this Court, as all courts do, must act to protect these fundamental constitutional rights. When the Church, as it has done here, shows that its constitutional rights will be infringed by requiring payment of taxes illegally assessed, this Court should allow for an injunction to challenge the tax prior to payment.

II. This Court should clarify its precedent on the important issue of law, incorrectly decided by the Appeals Court, regarding when a tax is imposed "without semblance of authority."

This Court has long held that a taxpayer may sue to enjoin the payment of taxes when the tax is imposed without semblance of authority. The Appeals Court held that the phrase "without semblance of authority" means actions that rise to the level of "legal fraud or the equivalent." Appeals Court Op. at 15. This Court should clarify its precedent on this point so that imposing taxes under circumstances such as are present in this case may be the subject of injunctive relief if equity would otherwise lie. The Appeals Court decision in this case unnecessarily restricted this Court's previous holdings as to what constitutes actions taken "without semblance of authority."

In a line of cases beginning in 1942, this Court recognized an exception to the general statutory rule that a taxpayer must first pay a tax before it can be

challenged as illegal. *See Nelsson v. Electrical Dist. No. 4*, 132 P.2d 632 (Ariz. 1942). In *Nelsson*, the taxpayer owned land that he claimed could not be taxed because it could not lawfully be included within the taxing district. *Id.* at 633. This Court reviewed the appropriate law regarding whether the taxpayer's land could lawfully be included within the electrical district and concluded that it could not. *Id* at 636. Because the taxpayer's land could not be included in the taxing district, "the trial court should have enjoined the district and defendants from attempting to levy any further district taxes thereon." *Id*. at 637.

In *Crane County v. Arizona State Tax Commission.*, 163 P.2d 656 (Ariz. 1945),[4] the State Tax Commission attempted to assess a tax on the sales of merchandise to contractors. This Court held that because the sale of merchandise was to contractors for the purposes of resale, it was a wholesale transaction and such a sale was not taxable under the retail taxation statute at issue. *Id*. at 661. The Court explained, "Here the injunction is sought not to prevent the execution of the statute but to prevent wrongful action on the part of the defendants under the guise of its enforcement or execution." *Id*. Because the Commission had acted beyond the statute in attempting to assess taxes on the transactions to the contractors, the Court held: "If, however, no tax results from the law, but there is an attempted collection of the tax which is claimed to result, when in fact there can be no tax, an

[4] O*verruled on other grounds not relevant herein by Valencia Energy Co. v. Arizona Dept. of Revenue*, 959 P.2d 1256 (Ariz. May 19, 1998).

injunction may issue…." *Id.* at 665. Applying this holding to the tax at issue, this Court stated, "The attempt of the commission to collect a tax which does not exist is without authority of law, beyond its powers, is illegal and a proper subject of injunction, the necessary elements for injunctive relief having been shown." *Id.*

In *Lane v. Superior Court*, 236 P.2d 461 (Ariz. 1951), this Court held that a property owner is not required to first pay a tax in order to challenge it if the tax was imposed "when there is no semblance of authority." *Id.* at 463. In that case, the superintendent of the Department of Motor Vehicles attempted to assess carriers a tax. *Id.* The carriers filed a lawsuit, arguing that the tax was not applicable to them. *Id.* at 462. This Court reaffirmed the ability of a taxpayer to bring an injunction action to restrain the collection of an illegal tax. It said:

> If a taxing official were to arbitrarily assess a tax against an individual who was patently not liable for the payment thereof, certainly no law would oblige that individual to pay the tax and then sue to recover it. In that case, an injunction would lie, because the official had acted without semblance of authority.

Id. at 463. The Court went on to say that the laws requiring payment of taxes before they may be challenged "cannot be well construed as requiring a property owner to pay a claim for taxes, when there is no semblance of authority for its imposition, before he may defend against it." *Id.* The Court held that the plaintiffs in *Lane* could not avail themselves of an injunction to restrain the tax because the burden of paying the tax first was "insignificant," meaning that they had an

adequate remedy at law to pay the taxes and then sue to recover them. *Id*. at 463.

In *Williams v. Bankers National Insurance Company*, 297 P.2d 344 (Ariz. 1956), this Court held that an insurance company could challenge by injunction the assessment of a tax imposed on it "without any authority of law." *Id*. at 350. The Arizona Insurance Code had changed, becoming effective on January 1, 1955, and instituting a one percent tax on premiums collected by certain insurance carriers. The Commission attempted to collect the one percent tax for 1954, but this Court held that an equitable action was appropriate because the tax was imposed with no semblance of authority. *Id*. at 350-51.*See also Smotkin v. Peterson*, 236 P.2d 743 (Ariz. 1951),[5] (reaffirming that "if there is no semblance of authority for the imposition of the tax, then injunction will lie."); *State Tax Comm'n. v. Superior Court*, 450 P.2d 103, 106 (Ariz. 1969) (stating that when there is no semblance of authority for the imposition of a tax, an injunction is appropriate); *cf Pittsburgh & Midway Coal Min. Co. v. Arizona Dep't. of Revenue*, 776 P.2d 1061, 1065 (Ariz. 1989) (holding that ambiguity in precedent cannot form the basis for an argument that state acted without semblance of authority).[6]

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[5] *Superseded by statute in part not relevant herein by* A.R.S. §41-1007(A), *as recognized in State Tax Commission v. Wallapai Brick & Clay Products, Inc.*, 330 P.2d 988 (Ariz. 1958).

[6] The Appeals Courts have issued decisions construing the phrase "without semblance of authority" but without setting forth any clear standard. *See Moore Business Forms, Inc. v. Arizona State Tax Comm'n.*, 448 P.2d 886 (Ariz. Ct. App.

The Appeals Court in this case defined the phrase "without semblance of authority" as actions amounting to legal fraud or the equivalent. Appeals Court Op. at 15. The Appeals Court then held that:

> The Assessor's initial position that Taxpayer must supply an I.R.S. letter of determination was wrong. Insistence on that method of proof, to the exclusion of all others, is inconsistent with recognized statutory options for proving tax-exempt status.

Id. at 16. But despite this holding, the Appeals Court, with no explanation, held that the Assessor in this case acted with semblance of authority. *Id*. at 17.

This holding is inconsistent with this Court's previous rulings regarding when injunction will lie against assessment of taxes. The Church in this case was plainly not liable for the payment of taxes. It presented its Articles of Incorporation and the required affidavit to the Assessor to prove its entitlement to exemption. Yet the Assessor went outside the bounds of the exemption statutes and grafted on an additional requirement for tax exemption for churches; a letter of determination from the IRS. This was not simply a request for additional information to prove entitlement to exemption. Rather, the Assessor was clear that the IRS letter was a "prerequisite to the property tax exemption process." (R1; p.6,

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1968) (holding that the Tax Commission's construction of a statute was with semblance of authority despite being later overturned by this Court); *Shew v. Jeffers*, 709 P.2d 549 (Ariz. Ct. App. 1985) (holding generally that the phrase "semblance of authority" applies when "the imposition of the tax is blatantly illegal."); *Scarmardo v. City of Lake Havasu*, 2010 WL 5059628 (Ariz. Ct. App. 2010) (holding that taxes imposed by irrigation district were with semblance of authority so injunction was not appropriate remedy).

Exh. C). He would not even *consider* the Church for a property tax exemption without an IRS letter. The Assessor was without any semblance of authority to impose this prerequisite for tax exemption.

Just as in *Nelsson* and *Crane*, it is plain in this case that the Church was not liable for the taxes that were imposed upon it. The letter it submitted from the Department of Revenue in 2009 confirms this fact. Nothing had changed in the interim but for the Church acquiring the letter from the Department of Revenue. Thus, no semblance of authority existed for the Assessor to impose the property taxes because the Church did not meet his extra-statutory "prerequisite" for property tax exemption. The Assessor was without semblance of authority to impose taxes on the Church and this Court should grant review to clarify its own precedent and to correct the Court of Appeals' decision to the contrary on this important issue of law.

Conclusion

The Church in this case stands to lose its free exercise of religion because the Assessor followed a policy that the Appeals Court held was wrong and contrary to law, yet refused to enjoin. The dismissal of this case removes from the Church its last chance to protect its ability to freely exercise its religion. The Church respectfully requests that this Court grant review to decide the important issues of law presented by this case.

Dated this 9th day of October, 2013.

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