ARIZONA COURT OF APPEALS

DIVISION TWO

DEBORAH HEWITT; JAN MITTELSTAEDT, Plaintiffs/Appellants, v. BOARD OF DIRECTORS OF THE ARIZONA COMMERCE AUTHORITY, et al., Defendants/Appellees.	Court of Appeals Division Two No. 2 CA-CV 2026-0013 Maricopa County Superior Court No. CV2025-001929

DEFENDANTS/APPELLEES' CONSOLIDATED RESPONSE TO AMICUS CURIAE BRIEFS

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Defendants/Appellees the Board of Directors of the Arizona Commerce Authority and the Arizona Department of Revenue respectfully respond to the three briefs filed in support of Plaintiffs/Appellants by amici curiae Warren Petersen, in his official capacity as the President of the Arizona State Senate (the "Senate President"); the Arizona Free Enterprise Club and the Grand Canyon Legal Center (collectively "AFEC"); and the Pelican Institute for Public Policy ("Pelican").

INTRODUCTION

The most notable feature of the three amicus briefs supporting Plaintiffs is what they concede. Each brief rests its argument on a distinction between refundable and nonrefundable tax credits. But to draw that line, each accepts the rule that decides this case: Under *Kotterman v. Killian*, a tax credit does not "amount[] to a 'gift'" because "[o]ne cannot make a gift of something that one does not own," and the state does not own the money a tax credit offsets. 193 Ariz. 273, 288, ¶ 52 (1999). A credit is applied in the course of calculating a taxpayer's liability before any final liability is determined, so the funds "remain in the taxpayer's ownership" when the credit does its work. *Id.* at 285, ¶¶ 39–40. The Supreme Court reaffirmed that rule in *Neptune Swimming Foundation v. City of Scottsdale*, 256 Ariz. 551, 560,

¶ 29 (2024), and the superior court correctly applied it to dismiss Plaintiffs' claims here. [ROA 77 ep 5.]

Plaintiffs reject *Kotterman*; they call its holding "dicta." (OB ep 20.) Their amici do not. On the contrary, each accepts *Kotterman*'s rule for tax credits that reduce liability. (Petersen Br. ep 6–7; AFEC Br. ep 10–11; Pelican Br. ep 13.) Each amicus instead stakes its entire argument on the assertion that the Gift Clause is implicated when a credit reduces a taxpayer's liability *below zero and results in a refund*. That distinction is wrong because every tax credit, refundable or not, is applied before the taxpayer owes the state anything. (§ I.A.) But even if the amici were right, their theory would fatally undermine Plaintiffs' claims. It contradicts Plaintiffs' insistence that refundability does not matter (§ I.B); it confirms that the Program has valid applications, which defeats the facial claim (§ I.C); and it would require an allegation the as-applied claims lack—that the two challenged credits will actually result in refunds (§ I.D).

The purported limiting principles that the amici offer all fail. (§ II.) And what remains of the amicus briefs is policy advocacy: arguments, founded on materials outside the record, that film incentives are unwise (§ III.A). That debate belongs in the legislature, not this Court. This appeal,

which arises from a Rule 12(b)(6) dismissal, would be the wrong vehicle for it in any event (§ III.B). The Court should affirm.

ARGUMENT

I. *Kotterman* correctly holds that tax credits do not implicate the Gift Clause, and the superior court correctly applied *Kotterman* to reject Plaintiffs' claims.

Kotterman holds that "a tax credit [does not] amount[] to a 'gift'" because "[o]ne cannot make a gift of something that one does not own." 193 Ariz. at 288, ¶ 52. And decisively, the state does not own the money a tax credit offsets. The state has no claim to a taxpayer's income until the final amount owed is calculated, *after* all deductions, exemptions, and credits; until then, the funds "remain in the taxpayer's ownership." *Id.* at 285, ¶¶ 39–40. Tax credits are therefore "credits against tax liability, not withdrawals from the state treasury[.]" *Cain v. Horne*, 220 Ariz. 77, 82, ¶ 22 (2009); *accord Neptune Swimming*, 256 Ariz. at 560, ¶ 29 ("[B]ecause the state does not own untaxed taxpayer income, foregoing collecting some of that income by applying the credit could not be a 'gift.'"). Applying *Kotterman*, the superior court correctly held that "tax credits are not gifts subject to Gift Clause analysis" and dismissed the Complaint. [ROA 77 ep 5.]

Plaintiffs reject *Kotterman*. They contend that its holding is "dicta" (OB ep 20), that the superior court "misread[]" it (OB ep 23), and that Defendants' reliance on it "elevates form … over substance" (RB ep 7–8). Yet the amici do not join that attack. The Senate President agrees that "[w]hen the government merely refrains—by extending an exemption, deduction, or offset—from taxing any or some portion [of] a citizen's private property, the Gift Clause generally is not implicated." (Petersen Br. ep 6–7.) AFEC calls Defendants' textual analysis of the Gift Clause "fair enough as to untaxed income" (AFEC Br. ep 10) and quotes *Neptune Swimming*'s reaffirmation of *Kotterman* with approval (*id.* ep 11). And Pelican does not contest *Kotterman*'s premise "for a credit that only reduces a tax bill." (Pelican Br. ep 13.)

The amici instead stake their arguments on a single distinction: that *Kotterman* does not reach credits that reduce a taxpayer's liability below zero and result in a refund. (Petersen Br. ep 17; AFEC Br. ep 9–10; Pelican Br. ep 13–14.) That distinction, they say, is "dispositive" (Petersen Br. ep 12), "essential" (AFEC Br. ep 22), and "critical" (Pelican Br. ep 16). The distinction is wrong, but even if it were right, it would not help Plaintiffs.

A. The amici's refundability line fails, because every tax credit is applied before the taxpayer owes the state anything.

The theory of the amici supporting Plaintiffs is that a tax credit becomes constitutionally problematic when a particular credit exceeds a particular taxpayer's tax liability for a single tax year, resulting in a refund. (*See* Petersen Br. ep 17; AFEC Br. ep 10; Pelican Br. ep 13–14.) That cannot be correct.

Most fundamentally, a tax statute's facial constitutionality cannot depend on individual taxpayers' tax liability in a given year. That is particularly true here, where Count 1 of Plaintiffs' Complaint is a facial challenge to the Program as a whole. [ROA 1 ep 18–20, ¶¶ 125–47.]

Moreover, *Kotterman*'s logic does not support the refundability distinction that the amici draw. *Kotterman* explains that "funds remain in the taxpayer's ownership *at least* until final calculation of the amount actually owed to the government, and upon which the state has a legal claim," and a credit *always* applies before a taxpayer's final obligation accrues. *Kotterman*, 193 Ariz. at 285, ¶ 40; *see also Stearns v. Ariz. Dep't of Revenue*, 212 Ariz. 333, 335, ¶ 12 (App. 2006). That is true for refundable and nonrefundable credits alike. And it is true for Program credits. Once a credit is applied, the taxpayer

may owe a balance, owe nothing, or hold an unused balance that the statute directs be paid, carried forward as a credit voucher, or both. A.R.S. §§ 42-1118(A), 43-1082(F), 43-1165(F). Paying out an unused balance is not a separate transfer of state funds; it is the rest of the same credit, which applied when the state owned nothing. Refundable or not, every credit reduces the amount the taxpayer could ultimately owe the government. (AB ep 45–46.)

Nor can the state's cutting a check demarcate the constitutional line, as AFEC and Pelican contend. (AFEC Br. ep 10, 12; Pelican Br. ep 13–14.) The state cuts checks all the time for nonrefundable credits. Consider a taxpayer with $10,000 in tentative tax liability who claims *Kotterman*'s $500 nonrefundable school tuition organization ("STO") credit, reducing her liability to $9,500. If her employer withheld $10,000 during the year, the state must send her a $500 check drawn on collected funds. A.R.S. § 42-1118(B). That check exists only because the credit reduced her liability, yet no one (besides Plaintiffs) contends it is a gift of public money. If mere check-writing triggered the Gift Clause, then the ordinary refunds generated from nonrefundable credits, deductions, and exemptions would trigger it too.

The Senate President hypothesizes (ep 15–16) that if Defendants were correct, then the payments at issue in *Turken v. Gordon*, 223 Ariz. 342 (2010),

and *Schires v. Carlat*, 250 Ariz. 371 (2021), could have been shielded from constitutional scrutiny by characterizing them as "refundable tax credit[s]." But whether particular transactions could be cast as tax credits does not turn on the refundable/nonrefundable distinction the Senate President urges. As the State's amicus brief explains, it may be that the legislature cannot "slap a rubber-stamp label of 'tax credit' on something that did not look like a bona fide or traditional tax credit." (State Br. ep 14.) But as the State explains, "nothing like that is present here." (*Id.*) Plaintiffs never alleged that the Program will produce a refund for anyone (§ I.C). And the Program credit operates in an ordinary way: computed on the return for a single specified taxable year, applied against liability, and administered under Title 42's refund provisions. A.R.S. §§ 43-1082(B), (D)(5), (F); 43-1165(B), (D)(5), (F); 42-1118.

The bottom line is that tax credits—like the Program credits here and the STO tax credits in *Kotterman*—reduce taxpayers' tax liability *in advance*. They therefore forgo money that does not belong to the state. *Kotterman* confirms that such prospective tax credits do not implicate the Gift Clause at all. And again, the entire Program's facial constitutionality cannot depend on individual taxpayers' withholding, tax liability, and credit amounts.

B. Even if the Gift Clause reached only credits that result in refunds, that theory would fatally undermine Plaintiffs' claims.

The amici's refund-only theory is at odds with Plaintiffs' theory of the case in any event. Plaintiffs allege that *every* Program credit violates the Gift Clause "whether a film company receives a refund or not" (OB ep 45), "in every application" (RB ep 26). They contend that the distinction between a refund and a reduction in liability "is not relevant" because the two are "the same thing, just viewed from different angles." (RB ep 31–32.) As the Arizona Chamber of Commerce & Industry observes, Plaintiffs' claim "is all or nothing": Plaintiffs "never raise as an alternative argument that the Program is only unconstitutional in part, i.e., in the instances where a refund is actually issued." (Chamber Br. ep 12–13.)

An amicus cannot supply a theory the party has disclaimed. And amici "have no right" to "introduce[] into the case" issues "never alleged in the complaint [or] contended by the plaintiffs[.]" *Bristor v. Cheatham*, 75 Ariz. 227, 230 (1953); *see City of Tempe v. Prudential Ins. Co. of Am.*, 109 Ariz. 429, 432 (1973). So the refund-only theory that the amici advance cannot rescue Plaintiffs' case. What the theory does instead is confirm why Plaintiffs' claims fail. Even if the Gift Clause were implicated by credits that result in

refunds, the Program would have valid applications, so Plaintiffs' facial claim fails (§ I.C, below). And Plaintiffs' as-applied claims would fail because they would require refund allegations that Plaintiffs never made (§ I.D, below).

C. Plaintiffs' facial claim fails because the Program has valid applications.

To prevail on their facial challenge, Plaintiffs must prove "no circumstances exist" under which the Program is constitutional. *State v. Burke*, 238 Ariz. 322, 325, ¶ 4 (App. 2015). The Arizona Supreme Court reaffirmed that standard two months ago: "The fact that the [law] might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid." *Ctr. for Ariz. Pol'y Inc. v. Ariz. Sec'y of State* ("*CAP*"), 592 P.3d 75, 86, ¶ 18 (Ariz. 2026) (quoting *United States v. Salerno*, 481 U.S. 739, 745 (1987)).[1]

[1] *Center for Arizona Policy* also addressed a weaker facial-challenge standard that applies only "[w]hen First Amendment interests are implicated." In that one circumstance, "a court may invalidate a statute as overbroad if a substantial number of its applications are unconstitutional, judged in relation to the statute's plainly legitimate sweep." 592 P.3d at 86, ¶ 19 (citation modified). Here, however, the more demanding standard applies: Plaintiffs must establish that "no set of circumstances exists under which the [Act] would be valid[.]" *Id.* ¶ 18 (internal quotation marks omitted).

The amici's own theory confirms that the Program has constitutional applications. For example, a recipient's tax liability may equal or exceed the credit. As another example, a recipient whose credit exceeds its liability may receive "a credit voucher" to be carried forward and applied in future years rather than any payment. A.R.S. §§ 42-1118(A), 43-1082(F); [ROA 1 ep 14, ¶ 93]. In those applications, the Program credit does exactly what the credit in *Kotterman* did: it reduces liability. Indeed, the *Kotterman* credit could itself be carried "forward for not more than five consecutive taxable years." 193 Ariz. at 277, ¶ 1. No amicus argues that a Program credit that only reduces tax liability violates the Gift Clause. Because at least those applications are constitutional, Plaintiffs cannot show the Program is invalid in every application and their "facial challenge must fail." [ROA 77 ep 6.]

In an effort to avoid that result, the Senate President proposes a new standard for facial challenges: that an improper legislative purpose "can engender a valid facial challenge, even if the law is otherwise susceptible to valid applications," a proposition drawn from an Establishment Clause case. (Petersen Br. ep 18, citing *Santa Fe Indep. Sch. Dist. v. Doe*, 530 U.S. 290, 314 (2000).) The Senate President cites no Arizona authority adopting that standard under the Gift Clause or otherwise. This Court is bound by the

facial-challenge standard that our Supreme Court has articulated. *CAP*, 592 P.3d at 86, ¶ 18.

The Senate President's reliance on *Fann v. State* (ep 20) fares no better: where *Fann* addressed facial validity, it applied the governing rule: "A facial challenge to the constitutionality of a statute requires a showing that no set of circumstances exists under which the statute would be valid." 251 Ariz. 425, 433, ¶ 18 (2021). The sections of *Fann* on which the Senate President relies involve severability. (Petersen Br. ep 20–21 (citing and quoting *Fann*, 251 Ariz. at 432, 438, 440–41, ¶¶ 13, 43, 54).)

Pelican likewise urges the Court to adopt a new standard for facial challenges. Instead of considering whether *all* applications of the Program are unconstitutional, it asks the Court to consider the *typical* application. Refunds, Pelican says, "are not a hypothetical edge case"; "historically" and in the "ordinary case," a film tax credit will result in a refund. (Pelican Br. ep 11, 15–16.) Set aside the factual assumption underlying that assertion. Pelican's novel standard is wrong as a matter of law. Even if the Program "might operate unconstitutionally" under the "set of circumstances" Pelican identifies, that is "insufficient to render [the Program] wholly invalid." *CAP*, 592 P.3d at 86, ¶ 18.

In any event, Plaintiffs never advanced the Senate President's or Pelican's novel facial-challenge theories, and courts do not "reach out to … upset established precedent when no party has raised or argued such issues." *Cruz v. Blair*, 255 Ariz. 335, 344, ¶ 32 n.5 (2023).

D. Plaintiffs' as-applied claims fail because Plaintiffs did not, and could not, allege that the challenged credits will result in refunds.

The amici's refund-only theory defeats Plaintiffs' as-applied claims too. Those claims target two credits, MoPic-2023-008 and MoPic-2024-004. To prevail, Plaintiffs "must show that the [Program] has been or is likely to be unconstitutionally applied to them." *CAP*, 592 P.3d at 108, ¶ 113. On the amici's theory, the allegedly unconstitutional application must produce a refund. Yet Plaintiffs never alleged that either credit has resulted or will result in a refund. [ROA 77 ep 6–7.] Indeed, Plaintiffs said that they "could not certify, consistent with their obligations under Ariz. R. Civ. P. 11(b), that refunds were likely to occur in those specific instances." (OB ep 51.)

What Plaintiffs *did* allege shows why that is so. As pleaded, whether a payment ever issues depends on contingencies: whether a credit clears post-approval and audit, whether the recipient's tax liability absorbs the credit, and whether any unused balance is "issued as a credit voucher to be carried

forward and applied against future tax liabilities." [ROA 1 ep 12, 14, 16, ¶¶ 72, 93, 109.] Each challenged credit, in other words, may simply reduce a tax liability or become a voucher. Those are applications that the amici (correctly) accept as constitutional.

The amici's own refund-only framework would, at a minimum, require Plaintiffs to plead that each challenged credit will result in a refund. Plaintiffs' failure to do so dooms their as-applied challenges even under the amici's theory. And Pelican's extra-record assertion that in this industry, "the refund is the design" (Pelican Br. ep 12) cannot supply allegations the Complaint lacks because review of a Rule 12(b)(6) dismissal is confined to the pleadings.

II. The amici's proposed limiting principles are unavailing.

The amici's attempts to contain the collateral damage that accepting Plaintiffs' theory would inflict similarly fail. Defendants explained that applying the Gift Clause to tax credits and treating forgone tax revenue as public money would expose to constitutional attack some 30 income tax credits (nine of them refundable), 16 transaction-privilege tax classifications, and longstanding charitable deductions. (AB ep 60–66.) Plaintiffs wave off the concern as "Defendants' parade of horribles." (RB ep 20.)

The amici instead suggest limiting principles to minimize the fallout. AFEC says "the breadth of the recipient class matters": a "modest, broadly available credit" differs from one "reserved for an extremely narrow class of favored enterprises." (AFEC Br. ep 8, 16–17.) Pelican contends that "[a] dependent credit, a property-tax relief credit, or a charitable-contribution credit … easily" survives the Gift Clause; that as to the nine refundable credits, "refundability triggers the Gift Clause's questions; it does not flunk them"; and that film credits are different because governments budget for them "like spending." (Pelican Br. ep 33–34.)

None of these proffered limits helps. First, they appear nowhere in the constitutional text. The Gift Clause prohibits gifts "to *any* individual, association, or corporation," Ariz. Const. art. 9, § 7 (emphasis added); as a textual matter, its application cannot turn on how many recipients are involved or on how a budget office classifies the credit.

Second, the limits would be impossible to administer. How "narrow [a] class" is too narrow? Would credits for renewable-energy producers survive? A.R.S. § 43-1164.03. How about credits for corporations conducting qualified research? A.R.S. § 43-1168. Neither the amici nor the Gift Clause supplies a metric. When the Gift Clause applies, it "is simply a check on the

proportionality of the deal that was chosen." *Neptune Swimming*, 256 Ariz. at 560, ¶ 32. So, if it were to apply to tax credits, even just refundable ones, then a court would scrutinize the "give" and "get" for all benefited taxpayers, whether they be a few film companies or all low-income taxpayers. *Id.*

Third, and relatedly, accepting the amici's proffered limits would still jeopardize tax credits that Arizonans depend on. Take the increased excise taxes credit, which is refundable and has been applied over 13 million times to deliver more than $600 million in relief to lower-income taxpayers. A.R.S. § 43-1072.01; (AB ep 63). The taxpayers who receive it tender no "consideration"; how would it survive Gift Clause scrutiny? The dependent, property-tax, and charitable-contribution credits face the same issue, and neither Plaintiffs nor their amici meaningfully account for the consequences.

Fourth, even with the amici's limits in place, every credit and every classification would become individually litigable. Pelican's answer, that "scrutiny is not invalidity" (Pelican Br. ep 33), is little comfort. Subjecting every tax credit to case-by-case, two-prong judicial review would convert settled tax policy into a litigation question, invite suits over every credit on the books, and unsettle the expectations of taxpayers who have structured investments around statutory credits. (*See* Chamber Br. ep 7–8.) *Kotterman*

refused to start down that "problematic" path, warning that if credits were public funds, "then so must [be] other established tax policy equivalents like deductions and exemptions," and that if "a credit and a deduction" were "an appropriation of public money," then courts would "be forced to rule that deductions for charitable contributions to private schools were unconstitutional." 193 Ariz. at 285, 288, ¶¶ 37–38, 50; (AB ep 60–66). This Court should likewise avoid that treacherous path.

III. The amici's policy arguments belong in the legislature and cannot be resolved in this posture.

A. The Court can disregard the amici's policy advocacy.

Much of the amicus briefing, and nearly all of Pelican's, is policy advocacy: a multistate survey of audits, news reports, and studies offered to show that film incentives do not pay for themselves (Pelican Br. ep 16–36); the legislature's decision not to extend an earlier film credit (AFEC Br. ep 20–21); and a fiscal note projecting that the Program would reduce General Fund revenue (Petersen Br. ep 18–19). Defendants do not engage that debate, because the Constitution assigns it to a different branch of government. Whether the Program is wise is "a policy matter for the legislature and the taxing authorities to address, rather than this court." *Kotterman*, 193 Ariz. at

287–88, ¶ 48; *accord id.* at 290–91, ¶ 63 ("[T]hat is a matter for the legislature, as policy maker, to debate and decide."). "[S]etting tax rates is a legislative function," which courts do not "usurp" by "substituting [their] concept of public policy for that of the legislative body." *Tanque Verde Enters. v. City of Tucson*, 142 Ariz. 536, 542 (1984). The legislature enacted the Program with fiscal projections before it (Petersen Br. ep 18–19), and it remains free to amend or repeal the Program, as it has done with other credits (Chamber Br. ep 10–11). However the policy debate comes out, it belongs in the legislature.

B. In any event, this appeal's posture forecloses any assessment of the Program's costs and benefits.

The amici's predictions about how the Program will perform also highlight that this appeal is the wrong vehicle for resolving any such dispute. The superior court dismissed the Complaint under Rule 12(b)(6). There are no answers, no discovery, and no findings, and the parties have never litigated Plaintiffs' claims on the merits. Review is limited to the Complaint (OB ep 18), and an appellate court "is precluded from receiving and considering new evidence, that is, evidence that is not part of the existing appellate record." *Royce C. v. Dep't of Child Safety*, 252 Ariz. 129, 138, ¶ 28 (App. 2021). Weighing the Program's benefits against its costs on this

record would be premature and speculative. That is one of the reasons facial challenges are disfavored: they "often rest on speculation" and risk deciding constitutional questions on a "factually barebones record." *CAP*, 592 P.3d at 86, ¶ 17 (internal quotation marks omitted).

CONCLUSION

This Court should affirm.

RESPECTFULLY SUBMITTED this 8th day of September, 2026.

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CERTIFICATE OF COMPLIANCE

1. This certificate of compliance concerns:

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Dated this 8th day of September, 2026.

/s/ Eric M. Fraser
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CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of September, 2026, the foregoing Response to Amici Curiae Briefs was served via the Court's E-Filer system and a copy served via email to:

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