

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

**ANSWERING BRIEF OF DEFENDANTS/APPELLEES
BOARD OF DIRECTORS OF THE ARIZONA COMMERCE
AUTHORITY AND ARIZONA DEPARTMENT OF REVENUE**

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INTRODUCTION

This is a case about whether tax credits implicate the Gift Clause. The Supreme Court answered that question 27 years ago. In *Kotterman v. Killian*, the Court held that a tax credit is not “public money” of the state and is not a “gift” within the meaning of the Gift Clause. [193 Ariz. 273 \(1999\)](#).

Plaintiffs nevertheless ask this Court to subject Arizona’s Motion Picture Production Program to Gift Clause scrutiny. Their theory would require this Court to disregard *Kotterman*, treat untaxed taxpayer income as state property, and reopen dozens of tax credits. The Constitution forbids that result. Setting tax policy is a legislative function, committed by the framers to the legislature’s broad discretion.

The superior court correctly dismissed Plaintiffs’ complaint on two independent grounds. First, the superior court held that under *Kotterman*, tax credits do not implicate the Gift Clause at all. Second, Plaintiffs’ claims fail even if *Kotterman* left open the constitutionality of refundable credits. Their facial claim fails because, at a minimum, credits that do not result in a refund do not violate the Gift Clause; Plaintiffs’ as-applied claims fail because they never alleged that any challenged credit has resulted, or will result, in a refund. This Court should affirm.

STATEMENT OF FACTS AND CASE

I. Arizona’s legislature enacts tax credits to benefit the public.

Arizona’s legislature has enacted dozens of state tax credits. These credits offer relief to families and taxpayers with dependents. *See, e.g.,* [A.R.S. §§ 43-1073](#) (family income credit), [43-1073.01](#) (dependent credit). They ease the burden of attending private school and paying for public school activities. [A.R.S. §§ 43-1089](#) (private school tuition organization credit), [43-1089.01](#) (public school contribution credit). Some credits encourage specific conduct, like the support of charities. [A.R.S. § 43-1088](#) (contribution to charitable organization credit). Others promote certain economic sectors, like small businesses. [A.R.S. § 43-1074.02](#) (investment in small business credit).

II. The Motion Picture Production Program.

In 2022, the legislature wanted “to promote the workforce development and expansion” of Arizona’s “commercial motion picture industry.” [ROA 2 ep 196.] To that end, it enacted HB2156, which created the Arizona Motion Picture Production Program. [ROA 2 ep 195–223.] HB2156 establishes criteria for eligible productions and production companies. [A.R.S. §§ 41-1517, 43-1082, 43-1165.](#)

An eligible production must be created by production activities in Arizona. [A.R.S. § 41-1517\(O\)\(1\)](#). For a production company to be eligible, it must hire Arizonans, keep a physical office in Arizona, film or produce its productions primarily in Arizona, and say in the closing credits that its productions were filmed in Arizona. [A.R.S. § 41-1517\(B\)](#).

Productions and production companies must apply for and receive pre- and post-approval before receiving a Program tax credit. [A.R.S. § 41-1517\(C\), \(G\), \(H\)](#). Each application must include an estimated total of expenditures in Arizona, the percentage of production to occur in Arizona, and the number of current and expected full-time employees to be hired in Arizona. [A.R.S. § 41-1517\(C\)](#).

Upon determination that all criteria are met, a production or production company receives preapproval. [A.R.S. § 41-1517\(G\)](#). The legislature limited the total preapproval of Program credits by calendar year: \$75 million in 2023, \$100 million in 2024, and \$125 million in 2025 and each subsequent year. [A.R.S. § 41-1517\(I\)](#).

Applicants must request post-approval after production is complete. [A.R.S. § 41-1517\(H\)](#). This post-approval application requires “an audited statement completed by a certified public accountant in [Arizona] that

certifies the total amount of eligible production costs associated with the production.” *Id.*

If a Program applicant’s credit exceeds the income taxes that would otherwise be eventually due, the applicant may receive a refund. [A.R.S. § 43-1082\(F\)](#). Any refund may be issued to the taxpayer as a lump sum, a credit voucher to be carried forward and applied in the future, or a combination of the two. [A.R.S. § 42-1118\(A\)](#).

III. This lawsuit.

Plaintiffs are two taxpayers who sued the Arizona Department of Revenue and the Board of Directors of the Arizona Commerce Authority, alleging the Program violates the Gift Clause.¹ [ROA 1 ep 1-5, ¶¶ 1-25.] They challenged the Program facially and as-applied to two specific credits. [ROA 1 ep 2, ¶¶ 1, 3-4.]

In their facial challenge, Plaintiffs contend the Gift Clause applies to all valuable tax advantages, including “credits or exemptions,” because the

¹ Plaintiffs also sued twenty-nine individuals in their official capacities as members and ex officio members of ACA’s Board of Directors. [ROA 1 ep 1-4, ¶¶ 6-22.] The superior court granted the parties’ stipulation to dismiss these individual defendants. [ROA 41.]

state “forego[es] the collection of income taxes” it could collect. [ROA 1 ep 18, 20, ¶¶ 127, 144.]

Plaintiffs also allege as-applied challenges to “MoPic-2024-004,” an allegedly pre-approved tax credit, and “MoPic-2023-008,” an allegedly post-approved tax credit. [ROA 1 ep 17, 20–21, ¶¶ 116–17, 148–58.] Although Plaintiffs allege MoPic-2023-008 could be claimed as a tax credit, they do not allege that either MoPic-2023-008 or MoPic-2024-004 has resulted or will result in any tax refund. [COA-*Id.* ep 21, ¶¶ 148–58.]

IV. The superior court dismissed Plaintiffs’ claims.

Plaintiffs moved for a preliminary injunction. [ROA 57.] Defendants opposed the injunction and moved to dismiss all claims. [ROA 42; ROA 70; ROA 71.]

The superior court granted Defendants’ motion to dismiss on two grounds. [ROA 77 ep 4–7.] First, the court concluded that the Arizona Supreme Court’s “*Kotterman* holding that tax credits are not gifts subject to Gift Clause analysis forecloses Plaintiff’s claims regarding the Program.” [COA-*Id.* ep 5.] That was true, the superior court explained, regardless of whether the tax credits at issue are refundable. [COA-*Id.*]

Second, the superior court concluded that Plaintiffs' claims failed "[e]ven if ... *Kotterman* did not specifically decide the constitutionality of tax credits tha[t] result in a refund under the Gift Clause." [COA-*Id.* ep 6-7.] Plaintiffs' facial challenge failed because they did not allege that Program credits "will always result in a refund." [COA-*Id.*] And Plaintiffs' as-applied challenges failed because they did not allege that MoPic-2024-004 or MoPic-2023-008 "will actually result in a refund." [COA-*Id.* ep 7.]

The court therefore dismissed the complaint and denied Plaintiffs' motion for a preliminary injunction as moot. [COA-*Id.*]

V. Final judgment and appeal.

The superior court entered final judgment on December 8, 2025. [ROA 81.] Plaintiffs filed a notice of appeal from the final judgment the same day. [ROA 82.]² The Court has jurisdiction over this appeal under [A.R.S. § 12-2101\(A\)\(1\)](#).

² Plaintiffs also filed a notice of appeal from the superior court's unsigned denial of the motion for a preliminary injunction. [ROA 78.] That was appeal No. 2 CA-CV 2025-0451. On February 17, 2026, this Court denied Plaintiffs' motion to consolidate the two appeals and dismissed appeal No. 2 CA-CV 2025-0451 for lack of jurisdiction.

STATEMENT OF THE ISSUE

Did the superior court correctly conclude that, under *Kotterman*, the Gift Clause does not apply to tax credits?

STANDARD OF REVIEW

The Court reviews the dismissal of a complaint de novo. *State ex rel. Brnovich v. Ariz. Bd. of Regents*, 250 Ariz. 127, 130, ¶ 7 (2020). Questions of statutory interpretation and constitutional issues are also reviewed de novo. *State v. Holle*, 240 Ariz. 300, 302, ¶ 8 (2016).

ARGUMENT SUMMARY

This case is governed by *Kotterman*, 193 Ariz. at 288, ¶ 52, which held that “a tax credit” does not “amount[] to a ‘gift,’” because “[o]ne cannot make a gift of something that one does not own.” The Arizona Supreme Court reaffirmed that core reasoning just two years ago in *Neptune Swimming Foundation v. City of Scottsdale*, 256 Ariz. 551, 560, ¶ 29 (2024). Because Plaintiffs’ entire complaint rests on the premise that the Motion Picture Production Program’s tax credits violate the Gift Clause, and *Kotterman* holds that tax credits do not implicate the Gift Clause in the first place, the superior court correctly dismissed every count. This Court should affirm. (Argument § I.A.1.)

The Gift Clause’s text, structure, and history independently confirm that result. The Clause forbids the state to “give,” “donate,” “grant,” or “subsid[ize]” —each of which presupposes that the state owns the thing transferred. [Ariz. Const. art. 9, § 7](#). The state does not own untaxed taxpayer income; it merely forgoes the collection of future revenue. Treating tax credits as gifts would mean that “all taxpayer income” is presumptively state property, *Kotterman*, [193 Ariz. at 285, ¶ 37](#), a result Arizona’s framers rejected when they committed “extremely broad discretion” over tax policy to the legislature. ([Argument §§ I.A.2-I.A.3](#).) No Arizona court has held that a prospective tax credit implicates the Gift Clause; this Court should not be the first.

This Court may also affirm on a second, independent ground: even if *Kotterman* left open whether *refundable* tax credits implicate the Gift Clause, Plaintiffs’ claims still fail on the pleadings. To win their facial challenge, Plaintiffs had to allege that no circumstance exists in which the Program could operate constitutionally, but they did not (and could not) allege that Program credits will *always* result in a refund. ([Argument § I.B.1](#).) Their as-applied challenges fail for the parallel reason that they did not allege that

either MoPic-2024-004 or MoPic-2023-008 will *actually* result in a refund to the specific taxpayers receiving them. ([Argument § I.B.2.](#))

Plaintiffs’ contrary arguments do not move the needle. They first try to recharacterize *Kotterman*’s holding as “dicta” and recast its reasoning as turning on whether the school tuition organization program “subsidized favored private interests.” Every Arizona court to interpret *Kotterman*—including the Supreme Court in *Neptune Swimming*—has read it the way the superior court read it here. Plaintiffs next argue that the difference between this Program and *Kotterman* is refundability, but *Kotterman* itself addressed the possibility of taxpayer “profit” and called it “a policy matter for the legislature”—not a constitutional one. [193 Ariz. at 287–88, ¶ 48.](#) Plaintiffs’ remaining arguments—that Program credits “deplete the public treasury” and constitute “tax expenditures”—were expressly raised and rejected in *Kotterman*. ([Argument § I.C.1.](#))

Plaintiffs’ fallback theory—that the Program “forgives” an “ascertained debt”—misunderstands how tax credits work. The Program credit is applied to a taxpayer’s *tentative* liability before any final obligation accrues, [A.R.S. §§ 42-1118\(A\), 43-1082\(B\), \(F\)](#), and may reduce only the year of post-approval or future years; it cannot wipe out prior-year liability.

Kotterman and Stearns v. Arizona Department of Revenue, [212 Ariz. 333](#) (App. 2006), confirm that credits attach before the state has any claim to the funds. Plaintiffs’ authorities (*Maricopa County* and *Pimalco*) involved *retroactive* legislation refunding amounts already owed and paid; the Program is purely prospective. ([Argument § I.C.2.](#))

Plaintiffs’ pleading arguments fare no better. Their claim that all Program credits lack public purpose and adequate consideration just restates their attack on *Kotterman*: under *Kotterman*, courts never reach the two-part Gift Clause test because tax credits do not trigger the Clause in the first place. And their concession that they “could not” allege refunds (because taxpayer information is confidential) does not excuse the pleading deficiency – it confirms it. ([Argument § I.C.3.](#))

The stakes of accepting Plaintiffs’ theory extend far beyond the Program. Dozens of Arizona tax credits, many of them refundable, would suddenly face constitutional attack. Various transaction-privilege tax classifications, including exemptions for businesses in the healthcare, banking, insurance, education, and farming industries, would be vulnerable. And as *Kotterman* warned, longstanding charitable deductions for donations

to schools, churches, and nonprofits would also be at risk. ([Argument § I.C.4.](#)) This Court should not unsettle 114 years of Arizona tax policy.

If the Gift Clause does apply to tax credits, Plaintiffs ask the Court to decide the merits of the case and enjoin the Program. Both requests are premature. First, this case arrives on a Rule 12(b)(6) record, with no answer, no discovery, and no findings. “[A] court of appeals sits as a court of review, not of first view.” *City of Flagstaff v. Ariz. Dep’t of Admin.*, [255 Ariz. 7, 14, ¶ 26](#) (App. 2023). If the Court reverses, the proper course is to remand so Defendants may answer and present their defense. ([Argument § II.](#)) Plaintiffs’ request for a permanent injunction is likewise premature because they have not prevailed after a final adjudication on the merits – an obvious necessary prerequisite for a permanent injunction. ([Argument § III.](#))

Finally, Plaintiffs lack taxpayer standing, and the Court may affirm on this alternative ground. Arizona taxpayer standing rests on the misappropriation of funds the state owns. *Ethington v. Wright*, [66 Ariz. 382, 386](#) (1948). Because the state does not own untaxed taxpayer income, taxpayers have no equitable interest in, and no standing to challenge, a tax credit that simply forgoes future revenue. *Welch v. Cochise County Board of*

Supervisors, [251 Ariz. 519](#) (2021), forecloses the diffuse “share of the burden” theory Plaintiffs assert. ([Argument § IV](#).)

The Court should affirm.

ARGUMENT

I. The superior court correctly dismissed Plaintiffs’ complaint.

“Because there is a strong presumption in favor of a statute’s constitutionality,” Plaintiffs bore “the burden of proving its unconstitutionality.” *State v. Guevara-Enriquez*, [576 P.3d 122, 127, ¶ 13](#) (Ariz. App. 2025), *review denied* (Mar. 3, 2026) (quotation marks omitted). The superior court correctly concluded that Plaintiffs failed to meet that burden and dismissed their complaint. This Court “may affirm the [superior] court’s grant of a motion to dismiss if it is correct for any reason.” *Old Republic Nat’l Title Ins. Co. v. New Falls Corp.*, [224 Ariz. 526, 530, ¶ 19](#) (App. 2010).

The superior court correctly dismissed Plaintiffs’ complaint for two independent reasons. First, the Supreme Court’s decision in *Kotterman* precludes Plaintiffs’ claims: Plaintiffs allege that the Program tax credits violate the Gift Clause, but *Kotterman* holds that tax credits do not implicate the Gift Clause in the first place. The plain text of the Gift Clause confirms that conclusion, as do the Constitution’s structure and history.

Second, the superior court correctly held that Plaintiffs' claims would fail even if *Kotterman* didn't decide whether *refundable* tax credits implicate the Gift Clause: Plaintiffs did not plead that Program tax credits will *always* result in a refund (which is fatal to their facial constitutional challenge), nor did they plead that the two specific credits they challenge will *actually* result in a refund (which is fatal to their as-applied challenges).

A. The superior court correctly concluded that Plaintiffs' claims fail because tax credits do not implicate the Gift Clause.

1. *Kotterman* precludes Plaintiffs' claims.

As the superior court concluded (ROA 77 ep 4), *Kotterman*'s central holding forecloses Plaintiffs' claims: "a tax credit" does not "amount[] to a gift," so tax credits do not implicate the Gift Clause. *Kotterman*, [193 Ariz. at 288](#), ¶ 52; see also *Neptune Swimming*, [256 Ariz. at 560](#), ¶ 29 (explaining that *Kotterman* "reasoned that because the state does not own untaxed taxpayer income, foregoing collecting some of that income by applying the credit could not be a 'gift.'"). Because *Kotterman* alone bars Plaintiffs' claims, Defendants discuss it in detail.

Kotterman involved a challenge to [A.R.S. § 43-1089](#), "which allows a state tax credit of up to \$500 for those who donate to school tuition

organizations (STOs).” *Kotterman*, 193 Ariz. at 276, ¶ 1. STOs provide “educational scholarships or tuition grants to children to attend [private schools] of their parents’ choice.” *Id.* (quoting A.R.S. § 43-1089(E)(2)).

The *Kotterman* plaintiffs claimed the STO tax credit violated the Gift Clause, 193 Ariz. at 284, ¶ 30, which forbids the state to “give or ... make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation,” Ariz. Const. art. 9, § 7. They also alleged the credit violated the Constitution’s Religion Clauses, which forbid “appropriation[s]” of “public money” to “religious establishment[s]” or “private or sectarian school[s].” *Kotterman*, 193 Ariz. at 284, ¶ 32 (quoting Ariz. Const. art. 2, § 12; *id.* art. 9, § 10). The Supreme Court rejected both challenges, holding—for identical reasons—that a credit that reduces a taxpayer’s liability is neither a gift nor an appropriation. *Kotterman*, 193 Ariz. at 285, 287–88, ¶¶ 40, 45, 52.

Beginning with the Religion Clauses challenge, the Court first concluded that a tax credit is not “public money.” The Court explained that “no money *ever* enters the state’s control as a result of this tax credit.” *Id.* at 285, ¶ 36. And the Court rejected the notion that “because taxpayer money *could* enter the treasury if it were not excluded by way of the tax credit, the state effectively controls and exerts quasi-ownership over it.” *Id.*, ¶ 37.

“[S]uch reasoning,” the Court warned, would mean that “all taxpayer income could be viewed as belonging to the state because it is subject to taxation by the legislature.” *Id.* It would also jeopardize “tax deductions for charitable contributions, including donations made directly to churches, religiously-affiliated schools and institutions,” because “[i]f credits constitute public funds, then so must other established tax policy equivalents like deductions and exemptions.” *Id.*, ¶ 38.

The Court avoided that dangerous path. Rejecting “the proposition” that a “tax return’s purpose is to return state money to taxpayers,” the Court decided instead that “funds remain in the taxpayer’s ownership *at least* until final calculation of the amount actually owed to the government.” *Id.*, ¶ 40. And that final calculation is made only *after* the taxpayer subtracts all “deductions,” “exemptions,” and “credits.” *Id.*, ¶ 39. Only at that point does the “state [have] a legal claim” to the taxpayer’s funds. *Id.*, ¶ 40. A credit, in other words, offsets the taxpayer’s tentative liability *before* the taxpayer owes anything, so the credited amount belongs to the taxpayer, not the state.

Having decided a tax credit is not money that the state owns, the Court readily concluded that a tax credit is not an appropriation. *Id.* at 287–88, ¶¶ 45, 50. “[R]educing a taxpayer’s liability,” the Court explained, is not “the

equivalent of spending a certain sum of money.” *Id.* at 287, ¶ 45. Further, “the prospect that an Arizona taxpayer might be able to make a profit by taking both the state tuition credit and a charitable deduction on the federal return ... in no way changes [the] constitutional analysis.” *Id.* at 287–88, ¶ 48.

Then, applying the same constitutional analysis, the Court concluded that a tax credit is not a gift. The Court had already decided that the state does not own tax credits. *Id.* at 285, ¶¶ 39–40. And “[o]ne cannot make a gift of something that one does not own.” *Id.* at 288, ¶ 52. So “a tax credit” does not “amount[] to a ‘gift.’” *Id.* The plaintiffs’ Gift Clause claim thus faltered at the threshold, and the Court did not need to evaluate whether the tax credit “served a public purpose” or was supported by “adequate consideration.” *Id.*, ¶ 51.

Here, faithfully applying *Kotterman*, the superior court rejected Plaintiffs’ Gift Clause challenge to the Program tax credits. The entire basis of Plaintiffs’ complaint is their assertion that the Program tax credits violate the Gift Clause: they claim the Program tax credits violate the Gift Clause on their face, as applied to one pre-approved credit, and as applied to one post-approved credit. [ROA 1 ep 18–21, ¶¶ 125–58.]

As the superior court explained, however, *Kotterman* holds “that tax credits that reduce tax liability are not gifts subject to Gift Clause analysis.” [ROA 77 ep 5.] This “forecloses Plaintiff[s’] claims regarding the Program” [COA-*id.*]: if tax credits do not implicate the Gift Clause in the first place, then the Program tax credits cannot violate the Gift Clause. “[B]ecause under Arizona law tax credits are not subsidies subject to Gift Clause analysis,” the superior court “[did] not need to decide whether the State receives adequate consideration for the tax credit.” [COA-*Id.* ep 4.] In this case, as in *Kotterman*, the Gift Clause claims failed at the outset because tax credits are not gifts and therefore do not implicate the Gift Clause.

“[T]he possibility that taxpayers will receive a refund” if “their liabilities don’t exceed the credit amount” did not change the analysis, the superior court explained. [COA-*Id.* ep 5.] The court correctly noted that *Kotterman* “addressed the issue of tax credits being applied in a way that would result in a ‘profit’ for individual taxpayers” but decided that was “‘a policy matter for the legislature and the taxing authorities to address rather than this court.’” [COA-*Id.* ep 6 (quoting *Kotterman*, [193 Ariz. at 287–88](#), ¶ 48).] The court thus concluded that *Kotterman*’s “broad holding that tax

credits are not gifts ... extends to credits that can result in a refund.” [COA-*Id.*]

Here, too, the superior court got it right. Recall that *Kotterman* concluded that the “state has a legal claim” to taxpayer income only *after* the taxpayer “take[s] certain deductions and exemptions” and then further subtracts “credits and other payments.” 193 Ariz. at 285, ¶¶ 39–40. Said otherwise, the state has no claim to taxpayer income before taxpayers take the credits to which they’re entitled. That is true regardless of whether the credits are refundable or nonrefundable. So the same analysis applies in both instances: “a tax credit” does not “amount[] to a ‘gift,’” because “[o]ne cannot make a gift of something that one does not own.” *Id.* at 288, ¶ 52.

The superior court correctly concluded that *Kotterman* alone disposes of Plaintiffs’ Gift Clause challenge to the Program tax credits.

2. The Gift Clause’s text does not apply to tax credits.

The plain text of the Gift Clause confirms that it does not apply to tax credits. The Court may affirm for this reason too. *Old Republic*, 224 Ariz. at 530, ¶ 19.

“‘When interpreting the scope and meaning of a constitutional provision,’” courts “start with the plain meaning of the constitutional text.”

Knight v. Fontes, 579 P.3d 1235, 1242, ¶ 19 (Ariz. 2025). “When the Arizona constitution does not define its terms, we look to their natural, obvious, and ordinary meaning, and our focus is on their meaning at the time the Constitution was adopted.” *Id.*, ¶ 20 (quoting *State v. Mixton*, 250 Ariz. 282, 290, ¶ 33 (2021)) (quotation marks omitted).

The Gift Clause says that neither the state nor any subdivision thereof “shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation.” *Ariz. Const. art. 9, § 7*. The term “gift,” as understood when this clause was adopted, means a “voluntary conveyance of land, or transfer of goods, from one person to another, made gratuitously.” *Gift*, *Black’s Law Dictionary* 540 (2d ed. 1910). The definitions of “donation,” “subsidy,” and “grant” are similar — each entails a party’s transferring something that it owns. *Donation*, *Black’s Law Dictionary* 392 (2d ed. 1910) (“A gift.”); *Subsidy*, *Black’s Law Dictionary* 1117 (2d ed. 1910) (“A grant of money made by government in aid of the promoters of any enterprise.”); *Grant*, *Black’s Law Dictionary* 547 (2d ed. 1910) (“A grant from the public ... of a power, license, privilege, or property, from the state or government to one or more individuals.”).

None of these terms includes tax credits. Each action—giving, conveying, and granting funds—requires that the state own the funds in the first instance. But as already explained, that isn’t how tax credits work. With a tax credit, “the taxing entity forgoes revenues that it could have chosen to collect in the future by changing its laws prospectively *so the taxpayers’ obligation to pay never arises.*” *Maricopa County v. State*, [187 Ariz. 275, 280](#) (App. 1996) (emphasis added). Because the taxpayers’ obligation to pay never arises, taxpayers still own their taxable income when they receive credits. The state never owns the funds, so it gives nothing away by not collecting them. *Kotterman*, [193 Ariz. at 285, 287–88, ¶¶ 40, 45, 52](#).

If tax credits were gifts, it could only be because the money belonged to the state in the first place. That would mean the future taxable income of every taxpayer—income not yet earned, by labor not yet performed—is presumptively state property. The state merely lets taxpayers keep some of their earned income. And if the state lets them keep more, that is a gift. That cannot be.

The state has no claim to taxpayer income until at least the final tax obligation is calculated, so credits taken before that point aren’t gifts made by the state. To conclude otherwise would “assume[] that income should be

treated as if it were government property even if it has not come into the tax collector's hands." *Ariz. Christian Sch. Tuition Org. v. Winn*, [563 U.S. 125, 144](#) (2011). Tax credits are not "gifts" as the Constitution uses that term.

Tax breaks—like credits, deductions, and exemptions—are also not "subsidies" under the Gift Clause. Plaintiffs argue (OB ep 27) for a broader definition, citing a reference to "tax breaks" in a contemporary (2024) edition of *Black's* (not an edition from when Arizonans adopted the Gift Clause). But the text Plaintiffs cite is not actually part of the definition of "subsidy." *Black's* offers a *definition* in the first sentence, with non-definitional information following a bullet:

subsidy (səb-sə-dee) *n.* (14c) 1. *A grant, usu[ally] made by the government, to any enterprise whose promotion is considered to be in the public interest.* • Although governments sometimes make direct payments (such as cash grants), subsidies are usu[ally] indirect. They may take the form of research-and-development support, tax breaks, provision of raw materials at below-market prices, or low-interest loans or low-interest export credits guaranteed by a government agency.

Subsidy, *Black's Law Dictionary* (12th ed. 2024) (emphasis added). Plaintiffs rely on the text *following* the bullet to argue that the definition of "subsidy" includes tax breaks. As *Black's* explains: "Bullets are used to separate definitional information (before the bullet) from information that is not

purely definitional (after the bullet), such as encyclopedic information or usage notes.” *Guide to the Dictionary, Black’s Law Dictionary* (12th ed. 2024).

Further, *Kotterman* held that tax breaks are not subsidies. Some commentators, relying on “[m]odern economic theory,” have urged a broader definition of “subsidy” that includes tax breaks. *Kotterman*, 193 Ariz. at 285, 286, ¶¶ 41-42. “Proponents of the concept argue that deductions, credits, exemptions, and exclusions constitute a form of hidden spending in the tax code.” *Id.*, ¶ 41 (cleaned up). *Kotterman* rejected that definition because it conflicts with the framers’ intent and “[m]odern economic theory does not necessarily govern constitutional interpretation.” *Id.* at 286, ¶ 42.

As the United States Supreme Court has recognized, “there is a constitutionally significant difference between subsidies and tax exemptions,” *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 590 (1997), and “[t]he grant of a tax exemption is not sponsorship,” *Walz v. Tax Comm’n of City of N.Y.*, 397 U.S. 664, 675 (1970). Indeed, “[t]ax exemptions and general subsidies . . . are qualitatively different” because an exemption “assists the exempted enterprise only passively, by relieving a

privately funded venture of the burden of paying taxes.” *Id.* at 690 (Brennan, J., concurring).

The Program tax credits are like tax deductions or exemptions. *See Kotterman*, 193 Ariz. at 288, ¶ 50 (there is “no constitutional difference between a [tax] credit and a deduction”). They are all “legitimate tools by which government can ameliorate [a] tax burden,” *id.* at 280, ¶ 15, and “forgo[] [tax] revenues,” *Maricopa County*, 187 Ariz. at 280. The difference between directly subsidizing private business and adjusting its tax burden is “constitutionally significant.” *Camps Newfound/Owatonna*, 520 U.S. at 590. All tax credits, exemptions, and deductions thus fall outside the Gift Clause’s term “subsidy or otherwise.” Ariz. Const. art. 9, § 7.

3. The Arizona Constitution’s structure and history show that setting tax policy is a legislative function.

Subjecting tax credits to Gift Clause scrutiny by the courts would also upset the Arizona Constitution’s structure and depart from history.

Article 3 of the Constitution divides “[t]he powers of the government of the state of Arizona ... into three separate departments, the legislative, the executive, and the judicial,” and requires that “such departments shall be separate and distinct, and no one of such departments shall exercise the

powers properly belonging to either of the others.” [Ariz. Const. art. 3](#). “Nowhere in the United States is this system of structured liberty more explicitly and firmly expressed than in Arizona.” *Mecham v. Gordon*, [156 Ariz. 297, 300](#) (1988).

The Constitution commits tax policy to the legislature. As the Supreme Court affirmed four decades ago, “setting tax rates is a legislative function,” which courts should 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). Under this “well-settled constitutional standard,” the legislature possesses “unlimited discretion to set the rate of taxation of a legally imposed revenue raising tax.” *Id.* at [539](#). That unlimited discretion necessarily includes the authority to increase taxes prospectively or, as here, to forgo the collection of prospective revenue altogether. *Id.*; *Kotterman*, [193 Ariz. at 285–86, ¶ 40](#).

This “‘extremely broad discretion’ in taxing matters” was a feature of the framers’ constitutional design. John D. Leshy, *The Making of the Arizona Constitution*, 20 *Ariz. St. L.J.* 1, 78 (1988) (quoting G.M. Bakken, *Rocky Mountain Constitution Making 1850–1912*, 53–63 (1987)). Indeed, “[s]pecial provisions limiting that discretion in dealing with mining or railroad

property were rejected,” despite the framers’ wariness of corporate interests. *Id.* George W.P. Hunt, President of the Constitutional Convention and Arizona’s first governor, explained that Arizona needed a constitution that “leaves the needed discretion to the legislature and permits accommodation to the changing needs of growing communities.” *The Records of the Arizona Constitutional Convention of 1910*, at 466 (John S. Goff ed., 1991) (hereinafter “Goff”).

From statehood on, the legislature has exercised its discretion both to impose and alleviate tax burdens. In 1912, the first legislature provided private-car companies with a special property tax in lieu of the General Property Tax. 1912 Ariz. Sess. Laws ch. 39. Twenty years later, the legislature enacted differential transaction-privilege tax treatment: most businesses would be taxed at 2.0%, but oil, gas, and railroad companies would be taxed at 0.5%, while insurance, banking, and certain mining businesses would be fully exempt. 1933 Ariz. Sess. Laws ch. 90.

The legislature has alleviated individual tax burdens with credits since the inception of income taxes. The legislature first imposed income taxes in 1933, two decades after statehood and the adoption of the Gift Clause. 1933 Ariz. Sess. Laws ch. 39. It authorized several tax credits, including credits for

“[a]n individual filer,” “[a] husband and wife or head of the family,” “[e]ach dependent child under 18 and other qualifying dependents,” and an additional credit for “[e]ach dependent child under 18 in a family headed by a widow or widower.” Ariz. Joint Legislative Budget Comm., *Historical Tax Law Changes: Individual Income Tax at 1*, available at <https://azjlbc.gov/08taxbook/iit.pdf>.

A decade later, the legislature “exempted from taxation the first \$1,500 earned by members of the United States Armed Forces or United States Merchant Marine.” *Id.* In 1954, it established “additional exemptions for blind persons, dependents and for estates and trusts.” *Id.* And in the decades that followed, the legislature has enacted, repealed, and amended a wide range of additional individual tax deductions, exemptions, and credits. *See generally id.* at 1–31. These include the STO credits at issue in *Kotterman*, as well as tax credits that encourage foster care ([A.R.S. § 43-1088](#)), support military families ([A.R.S. § 43-1086](#)), expand educational opportunities for disabled students ([A.R.S. §§ 43-1184, 43-1089.04](#)), and many others.

The legislature has similarly adopted and revised a huge variety of corporate income tax deductions, exemptions, and credits over the last 90 years. *See generally* Ariz. Joint Legislative Budget Comm., *Historical Tax Law*

Changes: Corporate Income Tax, available at <https://www.azjlb.gov/21taxbook/corptax.pdf>.

This sort of tax-policy tinkering is what legislatures do. See *Tanque Verde Enters.*, 142 Ariz. at 542. It is what Arizona’s framers gave the legislature discretion to do. And in the 114 years since Arizona entered the Union, no court has held that a prospective tax credit even implicated the Gift Clause, much less violated it. This Court should not be the first.

* * *

The Constitution’s text, structure, and history all confirm what *Kotterman* decided: tax credits do not implicate the Gift Clause. The superior court correctly concluded that, under *Kotterman*, “tax credits are not subsidies subject to Gift Clause analysis,” and dismissed Plaintiffs’ claims on that basis. [ROA 77 ep 4 (citing *Kotterman*, 193 Ariz. at 288).] This court should affirm.

B. The superior court correctly concluded that Plaintiffs’ claims would fail even if *Kotterman* did not decide the constitutionality of refundable credits.

The Court should also affirm on the superior court’s second, independent ground for dismissal: “[e]ven if ... *Kotterman* did not specifically decide the constitutionality of tax credits that result in a refund

under the Gift Clause,” all of Plaintiffs’ claims still fail, because Plaintiffs did not plead that all Program credits or even the specific ones they challenged will result in a refund. [COA-*Id.* ep 6.]

1. Plaintiffs’ facial challenge fails because if credits that do not result in a refund do not violate the Gift Clause, then at least those applications are constitutional.

Plaintiffs’ first claim is a facial challenge under the Gift Clause to the Program tax credits as a whole. [ROA 1 ep 18–20, ¶¶ 125–41.] To prevail on the facial challenge, Plaintiffs must prove “no circumstances exist” under which the Program would be found constitutional. *State v. Burke*, 238 Ariz. 322, 325, ¶ 4 (App. 2015). “The fact that the statute might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid.” *Stanwitz v. Reagan*, 245 Ariz. 344, 349, ¶ 19 (2018) (quotation modified).

Courts exercise caution with facial challenges because invalidating a statute with constitutional applications exceeds the role of the judiciary. *Wash. State Grange v. Wash. State Repub. Party*, 552 U.S. 442, 451 (2008). Ruling a statute facially unconstitutional “frustrates the intent of the elected representatives of the people.” *Id.* (internal quotation omitted). “Claims of facial invalidity often rest on speculation” and require courts to interpret

statutes “on the basis of factually barebones records.” *Id.* at 450 (internal quotation omitted).

Here, the superior court explained, “*Kotterman* conclusively established that tax credits that reduce tax liability do not violate the Gift Clause.” [ROA 77 ep 6.] But even if *Kotterman* did not decide whether a credit that results in the taxpayer’s receiving a refund implicates the Gift Clause, Plaintiffs’ facial challenge to the Program fails. [COA-*Id.*] That is because “Plaintiffs do not claim that the credits offered through the Program will *always* result in a refund.” [COA-*Id.* (emphasis added).] So even if credits that result in a refund violated the Gift Clause, and thus *some* applications of the Program were unconstitutional, that would not support a facial challenge. To prove their facial challenge, Plaintiffs must show the Program is unconstitutional in *all* its applications, and *Kotterman* confirms that at least the applications that do not result in a refund are constitutional.

A taxpayer may apply the Program credit yet receive no refund. In fact, no tax credit could guarantee a refund in all instances. A credit’s refundability turns on many factors, including each individual taxpayer’s income, exemptions, deductions, and credits. And even if those were the same for every taxpayer, so refunds were guaranteed, Program applicants

may pass their refunds to future tax years and never receive a refund payment at all. [ROA 1 ep 14, ¶ 93.] *See also* [A.R.S. §§ 42-1118\(A\), 43-1082\(F\)](#). Either way, the Program could provide credits that result in no refund. Because at least those nonrefundable applications are constitutional under *Kotterman*, Plaintiffs cannot prove that “no circumstances exist” under which the Program is constitutional. *Burke*, [238 Ariz. at 325, ¶ 4](#).

2. Plaintiffs’ as-applied challenge fails because they did not allege that the challenged credits would result in refunds.

The superior court correctly concluded that Plaintiffs’ as-applied challenges failed for a similar reason. Plaintiffs brought as-applied challenges against post-approved credit “MoPic-2023-008” and pre-approved credit “MoPic-2024-004.” [ROA 1 ep 20–21, ¶¶ 148–58.] But they did not allege that either credit “will result in a refund for either of the taxpayers who will receive them.” [ROA 77 ep 6.] Indeed, “[t]he tax liabilities of the taxpayers with the challenged credits may exceed the credit amount,” meaning the taxpayers would not receive a refund. [COA-*Id.* ep 6–7.] Whether *Kotterman* decided the constitutionality of refundable tax credits is therefore immaterial to Plaintiffs’ as-applied challenges: because Plaintiffs did not allege that either of the specific tax credits they challenge will result

in a refund, they cannot “point[] to refundability as the reason their challenge[s] to these specific tax credits survive *Kotterman*.” [COA-Id. ep 7.]

The Court should affirm the dismissal of Plaintiffs’ claims for this independent reason as well.

C. Plaintiffs’ contrary arguments all fail.

Each of Plaintiffs’ arguments for reversal falls short.

1. Plaintiffs cannot meaningfully distinguish *Kotterman*.

Because *Kotterman* is fatal to their claims, Plaintiffs attempt to limit and distinguish it in multiple ways. All those efforts fail.

a. For starters, Plaintiffs contend (OB ep 20) that *Kotterman*’s central holding—that tax credits are not gifts—is “dicta.” Rather, they say (OB ep 21), “the Supreme Court’s Gift Clause analysis in *Kotterman* turned on whether the program at issue subsidized favored private interests” and claim *Kotterman* “concluded that the STO program did not implicate that concern because it was a broadly available charitable program that allowed taxpayers to choose how to direct their funds and did not involve a direct state subsidy.” *Id.* That argument misrepresents *Kotterman*.

Arizona courts have always recognized *Kotterman*’s holding as its holding. In *Turken v. Gordon*, this Court described *Kotterman* as “holding

[that an] income tax credit is not a gift.” 220 Ariz. 456, 463, ¶ 18 n.7 (App. 2008), *rev’d on other grounds*, 223 Ariz. 342 (2010). And just two years ago in *Neptune Swimming*, the Supreme Court reaffirmed that, in *Kotterman*, “the Court reasoned that because the state does not own untaxed taxpayer income, foregoing collecting some of that income by applying the credit could not be a ‘gift.’” 256 Ariz. at 560, ¶ 29 (citing *Kotterman*, 193 Ariz. at 288, ¶ 52). That is exactly how the superior court described and applied *Kotterman* here. [ROA 77 ep 4–5.]

No court has even suggested what Plaintiffs assert: that *Kotterman*’s Gift Clause analysis “turned on whether the program at issue subsidized favored private interests.” (OB ep 21.) *Kotterman* itself refutes that claim. The Court noted that the historical purpose of the Gift Clause was “to protect against the ‘extravagant dissipation of public funds’ by government in subsidizing private enterprises such as railroad and canal building in the guise of the ‘public interest,’” and observed that “[s]uch ‘evils’ [did] not exist” in *Kotterman*. 193 Ariz. at 288, ¶ 52 (quoting *State v. Nw. Mut. Ins. Co.*, 86 Ariz. 50, 53 (1959)). But that observation did not drive the Court’s analysis; the Court did not even undertake the public-purpose inquiry that a Gift Clause analysis entails. See *id.*, ¶ 51.

Instead, the Court rejected Plaintiffs' argument "that a tax credit amounts to a 'gift'" in the first place, as "[o]ne cannot make a gift of something that one does not own." *Id.*, ¶ 52. That is *Kotterman*'s holding. That reasoning is the thread that runs through the entirety of the Court's state-constitutional analysis. See *id.*, ¶ 45 ("disagree[ing] with petitioners' characterization of this credit as public money or property within the meaning of the Arizona Constitution" and "[t]herefore" declining "to hold that a proscribed appropriation or application occurs by operation of this statute"); see also Clint Bolick, *Voucher Wars* 129–30 (2003) ("On the state constitutional issue, the [*Kotterman*] court ruled that the provision limiting the appropriation of government funds was not implicated, because a tax credit is not an appropriation—it's simply money that the state elects to leave in the hands of the taxpayer.").

b. Plaintiffs' other attempts to recast *Kotterman* likewise fall short. They claim (OB ep 23) "the *Kotterman* court was saying that the STO program worked by allowing taxpayers ... to direct their payments to a private party instead [of the government], and therefore that the taxpayers weren't getting anything and the government wasn't giving anything it either possessed or had the right to possess in the future." Plaintiffs continue that

the taxpayer in *Kotterman* was not specially enriched; indeed, she ended up no better off financially; the STO program merely allowed her to decide where her money would go. Nor was the government making a donation. The contribution came from the taxpayer's private funds, not from the State. If anyone made a gift, it was the taxpayer—not the government. What's more, the State was a passive actor. The government did not select beneficiaries, determine the amount of the benefit, or decide when it would be paid. It simply allowed taxpayers to redirect their own money.

OB ep 24.

Every aspect of that paragraph is inaccurate or misleading. The *Kotterman* Court *did* consider whether a taxpayer might end up “better off financially” (OB ep 24) and decided that whether a taxpayer “might be able to make a profit” off the STO tax credit “in no way changes [the] constitutional analysis.” *Kotterman*, [193 Ariz. at 287, ¶ 48](#).

Furthermore, the state *did* “select beneficiaries” (OB ep 24) under the STO program: although schools received “attenuated” benefits, the direct beneficiaries were the taxpayers who received the credit. *Kotterman*, [193 Ariz. at 287, ¶ 46](#). There, like here, the state established the criteria for the credit, including by specifying which taxpayers would be eligible to claim the credit. And for taxpayers that made the donation, the state *did* “determine the amount of the benefit” (OB ep 24): \$500. *Kotterman*, [193 Ariz.](#)

at 276, ¶ 1. Of course, that's how *every* tax credit, deduction, or exemption works: it benefits those who qualify for it in the amount specified.

Indeed, Plaintiffs (OB ep 23) are right in only one crucial respect: in *Kotterman*, “the government wasn’t giving anything it either possessed or had the right to possess in the future.” But the same is true here, and it is fatal to Plaintiffs’ claims. The reason why the state wasn’t giving anything in *Kotterman* (or here) is “because the state does not own untaxed taxpayer income” and thus “foregoing collecting some of that income by applying [a tax] credit could not be a ‘gift.’” *Neptune Swimming*, 256 Ariz. at 560, ¶ 29 (citing *Kotterman*, 193 Ariz. at 288, ¶ 52). Again, that is true of *every* tax credit, deduction, or exemption that reduces a taxpayer’s liability in advance, like the Program tax credits here. See Bolick, *Voucher Wars* at 119 (describing the *Kotterman* defense strategy as “decid[ing] to take our first stand on the nature of tax credits, which in our view were not ‘public funds’ at all, because the money belonged to the taxpayers and never came under the state’s control.”).

c. Plaintiffs nonetheless (OB ep 31 n.17) try to “cabin[]” *Kotterman*’s holding “to the specific facts of the case,” noting that, in ¶ 45, *Kotterman* refers to “this credit” and “this statute.” But *Kotterman*’s reasoning

about how tax credits work is not limited to the STO credit. The Court rejected the basic proposition that “a tax credit constitutes public money,” *Kotterman*, 193 Ariz. at 285, ¶ 40, and “that a tax credit amounts to a ‘gift,’” *Id.* at 288, ¶ 52. Those holdings apply with equal force to the tax credits at issue here.

d. Plaintiffs try to distinguish *Kotterman* (OB ep 21, 25) on the ground that the tax credit there was nonrefundable whereas the tax credit here could result in a refund, meaning the taxpayer could get a “check.” But as the superior court noted, *Kotterman* “addressed the issue of tax credits being applied in a way that would result in a ‘profit’ for individual taxpayers.” [ROA 77 ep 6.] In dissent, Justice Feldman warned that taxpayers “may well make a profit” and receive “a dollar-for-dollar refund” from the STO tax credit. *Kotterman*, 193 Ariz. at 309–10, ¶ 148 n.17 (Feldman, J., dissenting). The Court, however, found that such concerns were “a policy matter for the legislature and the taxing authorities to address, rather than [the] court.” *Id.* at 287–88, ¶ 48. The possibility of a “profit” “in no way change[d] [the Court’s] constitutional analysis.” *Id.*

Plaintiffs argue (OB ep 25–26) that *Kotterman* addressed a different issue: taxpayers’ taking the state tax credit and then taking a federal

charitable tax deduction on top of it. But again, as the superior court concluded, *Kotterman*'s underlying logic is fatal to Plaintiffs' claims here. [ROA 77 ep 6.] As noted ([Argument § I.A.1](#)), *Kotterman* explained that *before* a taxpayer takes all deductions, exemptions, and credits, the state has no claim on the taxpayer's income. [193 Ariz. at 285, ¶¶ 39–40](#). *After* a credit is applied, a taxpayer may eventually owe a balance (positive liability), owe nothing (zero liability), or receive a refund (negative liability). But all tax credits—refundable or not—do one thing: reduce the amount of money the taxpayer *could* ultimately owe the government. Because that future obligation is not yet final or due when the credit is taken, the credit is not a “gift” that the state gives the taxpayer. [Id. at 285, ¶¶ 39–40](#); [id. at 288, ¶ 52](#). That is true whether the tax credit is or isn't refundable.

Refundability is also beside the point given how Plaintiffs pled their claims. As discussed above ([Argument § I.B.1](#)), and as the superior court explained, “*Kotterman* conclusively established that tax credits that reduce tax liability do not violate the Gift Clause.” [ROA 77 ep 6.] But even if *Kotterman* applied only to nonrefundable tax credits and left the constitutionality of refundable ones undecided, “Plaintiffs do not claim that the credits offered through the Program will *always* result in a refund.”

[COA-*Id.* (emphasis added).] Because *Kotterman* confirms that at least some (nonrefundable) applications of the Program are constitutional, Plaintiffs’ “facial challenge must fail.” [COA-*Id.* (quoting *Burke*, 238 Ariz. at 325, ¶ 4).] (See [Argument § I.B.1](#), above.)

Refundability is irrelevant to Plaintiffs’ as-applied challenges, too, because they do not allege that either of the specific tax credits they challenge has resulted or will result in a refund. [ROA 1 ep 20–21, ¶¶ 145–58.] This is fatal to their as-applied claims, as the superior court concluded. [ROA 77 ep 6–7.] (See [Argument § I.B.2](#), above.) Whether a refund materializes turns on variables Plaintiffs have not alleged, including individual taxpayers’ income and other credits and deductions. In any event, Plaintiffs themselves recognize that the Program credit may be issued as a credit voucher carried forward rather than disbursed as a refund. [ROA 1 ep 14, ¶ 93.] A credit voucher would not involve the state’s paying money to anyone.

e. Refundability aside, Plaintiffs run headlong into *Kotterman* without even attempting to distinguish it. For instance, they argue (OB ep 29) that, “[a]s a practical matter, this Program’s credits deplete the public treasury in exactly the same way as direct appropriations: every dollar offset against a private company’s tax liability is one less dollar available for public

use[.]” *Kotterman* rejected this exact argument. There, the plaintiffs argued “that because taxpayer money *could* enter the treasury if it were not excluded by way of a tax credit, the state effectively controls and exerts quasi-ownership over it.” *Kotterman*, 193 Ariz. at 285, ¶ 37. The Supreme Court rejected “[t]his expansive interpretation” that was “fraught with problems,” *id.*, and concluded that tax credits are not appropriations, *id.* at 287, ¶ 45.

In the same vein (OB ep 30), Plaintiffs claim that tax credits are “tax expenditures,” citing an Arizona Department of Revenue webpage. This webpage cannot determine the scope of constitutional terms. ADOR’s online report is a budget-analysis tool that describes the fiscal impact of credits; it does not purport to characterize the legal nature of tax credits for constitutional-analysis purposes. And in any event *Kotterman* squarely rejected this argument. There, as here, the plaintiffs advanced a “‘tax expenditure’ approach” to constitutional interpretation to “argue that deductions, credits, exemptions, and exclusions ‘constitute a form of hidden spending in the tax code and ought accordingly to be compared with equivalent nontax spending programs.’” 193 Ariz. at 286, ¶ 41. But whatever the utility of that theory “for analyzing budgetary policy,” the Court rejected

it as a mode of constitutional interpretation. *Id.* *Kotterman* requires that this Court do the same.

2. The Program credit adjusts prospective tax liability and does not wipe out any taxpayer debt.

Venturing beyond *Kotterman*, Plaintiffs argue (OB ep 24) that “the government can[not] eliminate liabilities owed to it without transgressing the constitutional prohibition on subsidies,” noting (OB ep 27) that the Gift Clause “has been applied to debt forgiveness, below-market leases, and in-kind aid.” That is irrelevant because the Program does none of those things.

Plaintiffs argue (OB ep 32) that because “the government ... *does* ‘own’ a tax liability,” “this is a situation where the government is forgiving an *ascertained debt that’s owed to it*,” which “triggers Gift Clause scrutiny.” Plaintiffs are wrong. Again, tax credits—including the Program credits—are applied to a taxpayer’s “*tentative*, not *actual*, tax liability,” meaning that tax credits are applied *before* a taxpayer owes anything. *Kotterman*, 193 Ariz. at 285, ¶ 39. When a taxpayer claims the Program tax credit, the taxpayer’s final tax liability has not yet been calculated, so the state has no claim on the taxpayer’s funds, and the taxpayer has no “debt” to forgive. *Id.*, ¶ 40. Tax

credits reduce a taxpayer's *future* obligation, not a previously incurred one. *Id.*, ¶¶ 39–40.

Plaintiffs' own authorities (OB ep 32 n.18) confirm this point. In *Stearns v. Arizona Department of Revenue*, 212 Ariz. 333 (App. 2006), this Court described the same tax-calculation sequence *Kotterman* recognized: apply additions and subtractions to calculate adjusted gross income, deductions and exemptions to calculate taxable income, and eventually credits to calculate "ultimate tax liability." *Id.* at 335, ¶ 12. As in *Kotterman*, credits apply *before* the liability amount is calculated or owed to the state. 193 Ariz. at 285, ¶ 39.

Helvering v. Horst, 311 U.S. 112 (1940), does not suggest otherwise. There, the Court recited "the rule that income is not taxable until realized." *Id.* at 115–16. But the realization of taxable income does not transfer ownership from taxpayer to the state. As *Kotterman* explained, earned income "remain[s] in the taxpayer's ownership" and does not "instantly become public money" just because it is "taxable." 193 Ariz. at 285, ¶ 40.

Plaintiffs also contend (OB ep 32) that "recipients ... obtain[] the [Program] credit to cancel tax obligations on prior-year returns." This is wrong too: the Program does not cancel taxes due from prior-year returns.

By law, taxpayers must claim the credit in “the taxable year in which the Arizona commerce authority issued the postapproval,” [A.R.S. § 43-1082\(B\)](#), and may apply it only to that year or future tax years, [A.R.S. §§ 42-1118\(A\), 43-1082\(F\)](#). The Program does not permit retroactive application to past tax years. [A.R.S. §§ 42-1118\(A\), 43-1082\(F\)](#).

The Program’s prospective design confirms that the Program tax credits do not implicate the Gift Clause at all. Plaintiffs (OB ep 33–34) cite two pre-*Kotterman* decisions in which this Court applied the Gift Clause to retroactive tax legislation: *Maricopa County v. State*, [187 Ariz. 275](#) (App. 1996), and *Pimalco, Inc. v. Maricopa County*, [188 Ariz. 550](#) (App. 1997).

The first case involved a statute that retroactively reclassified property for prior tax years and directed refunds of taxes already paid. *Maricopa County*, [187 Ariz. at 280](#). In evaluating a Gift Clause challenge to the statute, the Court distinguished between two categories of tax legislation. In the first, “the taxing entity forgoes revenues that it could have chosen to collect in the future by changing its laws prospectively so the taxpayers’ obligation to pay never arises.” *Id.* In the second category, “the taxing entity modifies its laws to impose on itself an obligation to refund revenues that it collected lawfully in the past.” *Id.*

The Court held that only the second category—legislation that retrospectively “annul[s] closed taxing transactions”—implicates the Gift Clause because only there does the state surrender revenues in which it holds a concrete property interest. *Id.* The statute at issue fell into this second category. *Id.* It implicated the Gift Clause because it retroactively reclassified property for prior tax years and directed refunds of taxes already paid. *Id.* Ultimately, however, the Court found no Gift Clause violation. *Id.* at 281.

Pimalco applied the same framework with the same result. The legislature retroactively reclassified possessory interests in tribal lands from a twenty-five percent rate to a one percent rate. *Pimalco*, 188 Ariz. at 553. Taxpayers sought refunds of the difference—roughly 96% of taxes already assessed and collected in a past tax year. *Id.* at 559. The Court applied the Gift Clause because the statute retroactively annulled a closed taxing transaction and directed the return of revenues owned by the state. *Id.* (citing *Maricopa County*, 187 Ariz. at 280). Again, however, the Court ultimately found no Gift Clause violation. *Id.* at 561.

Critically, both *Maricopa County* and *Pimalco* “took care to distinguish retrospective laws that eliminate *existing* tax obligations from laws that simply cut taxes prospectively, or offer tax credits or deductions or

incentives for future activities.” Timothy Sandefur, *The Arizona Gift Clause in the Twenty-First Century*, 16 *Drexel L. Rev.* 299, 352 (2024). “That makes sense: it would be absurd to hold that laws that cut taxes qualify as unconstitutional gifts—that would deprive the legislature of its sovereign authority to set taxes[.]” *Id.*

Here, unlike in *Maricopa County* or *Pinalco*, the Program tax credits are prospective: they were established in advance to reduce *future* tax liabilities. They reduce taxpayers’ tentative liability *before* any final obligation exists. *Kotterman*, 193 *Ariz.* at 285, ¶ 39; *Stearns*, 212 *Ariz.* at 335, ¶ 12. And they apply only to the year of post-approval or future years. A.R.S. §§ 42-1118(A), 43-1082(B), (F). The Program tax credits therefore fall into *Maricopa County*’s first category—where the taxpayer’s obligation never arises, the state acquires no property interest, and the Gift Clause is not implicated. 187 *Ariz.* at 280.

None of the other cases Plaintiffs cite (OB ep 24, 34) suggests a different result. All involve either a retrospective change to existing liability, a non-tax payment, or both—not a prospective tax adjustment like the Program. See *Puterbaugh v. Gila County*, 45 *Ariz.* 557, 561 (1935) (legislature barred collection of existing debt owed to state); *Duke v. Yavapai County*, 24 *Ariz.*

567, 573 (1923) (county paid private party's existing tax liability); *Rowlands v. State Loan Bd. of Ariz.*, 24 Ariz. 116, 123 (1922) (legislature forgave existing interest owed on state-owned mortgages); *City of Bayonne v. Palmer*, 217 A.2d 141, 160–61 (N.J. Super. Ct. Ch. Div. 1966) (elimination of existing tax liability); *City of Ojai v. Chaffee*, 140 P.2d 116, 120 (Cal. Dist. Ct. App. 1943) (cancellation of existing taxes already levied on foreclosed property); *Tex. & New Orleans R.R. Co. v. Galveston County*, 161 S.W.2d 530, 532 (Tex. App. 1942), *aff'd*, 169 S.W.2d 713 (Tex. 1943) (in non-tax case, county indemnified railroad's future tort liability for 999 years).

Nor is the Gift Clause the “consistently and strictly applied” all-purpose check on government activity that Plaintiffs portray (OB ep 12). The Supreme Court has held that state pension and retirement benefits, for example, do not implicate the Gift Clause at all. *Yeazell v. Copins*, 98 Ariz. 109, 112–13 (1965); *McClead v. Pima County*, 174 Ariz. 348, 358 (App. 1992). Although a “great majority” of states disagreed, the *Yeazell* Court adopted the modern exception that state pensions offered pursuant to statute were not gifts. See *Hall v. Elected Offs.’ Ret. Plan*, 241 Ariz. 33, 40, ¶ 19 (2016); *Yeazell*, 98 Ariz. at 112–13. The *Yeazell* Court adopted this exception “largely because any other conclusion would have resulted in the unconstitutionality of the

entire retirement system.” *Proksa v. Ariz. State Sch. for the Deaf & the Blind*, 205 Ariz. 627, 631, ¶ 21 (2003).

Indeed, throughout Arizona history, courts have routinely upheld arrangements conferring substantial benefits on private actors without finding a Gift Clause violation. Most recently, in *Neptune Swimming*, the Court found no Gift Clause violation where a city “[g]ranted a private enterprise exclusive use of City-owned property” to the lower bidder in a request-for-proposal process. 256 Ariz. at 560–62, ¶¶ 28, 31–40.³ In *Town of Gila Bend v. Walled Lake Door Co.*, for instance, the Court upheld a government contract to build a 6,000-foot water line for a private company’s facility. 107 Ariz. 545, 547, 550 (1971). In *Humphrey v. City of Phoenix*, the government subsidized the construction of low-income housing for private occupants and the Court held it was “not a gift or loan to anyone.” 55 Ariz. 374, 387 (1940). And in *South Side District Hospital v. Hartman*, the government leased property to a private hospital for one dollar per year

³ Plaintiffs (OB ep 12) describe *Neptune Swimming* as a decision “striking down even indirect or non-monetary benefits as unconstitutional subsidies,” but in fact the Supreme Court *rejected* the Gift Clause claim in that case, 256 Ariz. at 562, ¶ 40.

under what the Court called a “loose arrangement,” yet found no Gift Clause violation. [62 Ariz. 67, 69, 74](#) (1944).

Government-funded water lines, subsidized housing, and a dollar-per-year lease to a private hospital all survived Gift Clause scrutiny. A tax credit reducing tentative future liability that the state does not own presents an even easier case that *Kotterman* already resolved. [193 Ariz. at 288, ¶ 52](#); accord *Maricopa County*, [187 Ariz. at 280](#) (holding that the Gift Clause does not apply where “the taxing entity forgoes revenues that it could have chosen to collect in the future”).

3. Plaintiffs did not adequately plead their claims.

Plaintiffs’ attempts to explain (OB ep 45–52) why they adequately pleaded their facial and as-applied claims just underscore how sweeping their theory is and why this Court should reject it.

a. Beginning with their facial challenge, Plaintiffs argue (OB ep 45) “[t]he superior court misconstrued” the challenge “when it concluded that ‘Plaintiffs do not claim that the credits offered through the Program will always result in a refund, so their facial challenge must fail.’” [Quoting ROA 77 ep 6.] Plaintiffs clarify (OB ep 45–47) that they “allege, and argued below, that Program credits—whether refundable or not—*always* violate *both*

elements of the Gift Clause analysis” because Program tax credits always lack a public purpose and are always supported by inadequate consideration.

Plaintiffs’ attempt to revive their facial challenge just amounts to an attack on *Kotterman*. As explained, and as the superior court correctly recognized [ROA 77 ep 4], *Kotterman* stands for the proposition that tax credits aren’t gifts under the Gift Clause. Because Gift Clause challenges to tax credits fail at the threshold, a court doesn’t need to evaluate whether a tax credit serves a public purpose or is supported by adequate consideration. [COA-*Id.*]

So alleging that *all* credits lack a public purpose or adequate consideration doesn’t cure Plaintiffs’ threshold problem: under *Kotterman*, tax credits do not trigger Gift Clause scrutiny in the first place. It does underscore that Plaintiffs’ attack isn’t just on the Program credits but on *all* tax credits “whether refundable or not” (OB ep 45). It is thus an attack on *Kotterman* itself, which Plaintiffs repeatedly emphasize (*e.g.*, OB ep 47) involved a nonrefundable credit.

Plaintiffs protest (OB ep 47) that “[a]ctually, *Kotterman* ... actually *applied* the Gift Clause framework to the nonrefundable tax credits at issue

there.” Not so. *Kotterman* quoted the constitutional text and noted the two-element test for Gift Clause challenges, but the Court did not apply that test; instead, it noted that the historical purpose of the Gift Clause wasn’t implicated and disagreed with the plaintiffs “that a tax credit amounts to a ‘gift’” at all:

Under article IX, § 7, the state shall not “give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation.” We have upheld giving when the state action served a public purpose and adequate consideration was provided for the public benefit conferred. See *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 348-49 (1984) (holding that state payment of portion of teacher association president's salary did not violate anti-gift clause).

This constitutional provision was historically intended to protect against the “extravagant dissipation of public funds” by government in subsidizing private enterprises such as railroad and canal building in the guise of “public interest.” *State v. Northwestern Mutual Ins. Co.*, 86 Ariz. 50, 53 (1959) (citation omitted). Such “evils” do not exist here. Neither do we agree with petitioners that a tax credit amounts to a “gift.” One cannot make a gift of something that one does not own.

Kotterman, 193 Ariz. at 288, ¶¶ 51-52.

b. Plaintiffs’ defense of their as-applied challenges similarly illustrates their war with *Kotterman*. Plaintiffs acknowledge (OB ep 48) that the superior court “dismissed [their] as-applied challenges in part” because

“the [c]omplaint doesn’t allege the challenged credits will result in refunds to the specific film production companies claiming them.” “But,” Plaintiffs insist (OB ep 48–50, 51), “a refund is not the only way the credits may violate the Gift Clause,” because Plaintiffs claim they lack a public purpose and adequate consideration. Again, this just disregards *Kotterman*, which never reached the two-part Gift Clause test because tax credits do not implicate the Gift Clause. [193 Ariz. at 288, ¶¶ 51–52](#).

Plaintiffs also say (OB ep 50) that “[n]othing in the law requires [them] to show *which particular companies* will receive subsidies, especially at the pre-discovery stage.” That is a red herring: nothing in the superior court’s order faults Plaintiffs for not identifying which companies applied for the specific credits that Plaintiffs challenge.

Instead, as explained ([Argument § I.B.2](#)), the superior court dismissed Plaintiffs’ as-applied challenges because even if *Kotterman* did not resolve the constitutionality of refundable tax credits, Plaintiffs did not plead that either of the specific credits they challenge “will result in a refund for either of the taxpayers who receive them.” [ROA 77 ep 6.] Plaintiffs do not dispute that they didn’t plead those facts. Indeed, they acknowledge (OB ep 51) that they *could not* allege that “the specific credits would ultimately result in

refunds” because Arizona law keeps individual taxpayers’ information confidential. But that fact does not excuse Plaintiffs from adequately pleading their claims. Instead, it just confirms why they necessarily fail. And contrary to Plaintiffs’ assertion (OB ep 52), nothing in *Schires v. Carlat*, 250 Ariz. 371, 378, ¶ 21 (2021), or otherwise supports “limited discovery” into individual taxpayers’ confidential information so that would-be plaintiffs could challenge others’ tax returns. Doing so would create havoc that this Court should avoid.

4. Applying the Gift Clause to prospective tax credits would jeopardize Arizona’s tax framework.

The collateral damage from accepting Plaintiffs’ theory of the Gift Clause would not end there. To hold that tax credits implicate the Gift Clause would subject the legislature’s most basic tax-policy decisions to unprecedented, unwarranted, and unworkable constitutional scrutiny, expose dozens of existing state credits to constitutional attack, and cast doubt on charitable deductions that channel donations to Arizona churches, schools, and nonprofits. The Court can and should avoid that result.

The most obvious consequence of reopening the question that *Kotterman* settled would be to subject STO tax credits to constitutional

scrutiny all over again, 27 years later. But the impact would be far broader, because Arizona law currently includes 30 tax credits, including credits for:

- agricultural pollution control equipment ([A.R.S. § 43-1081.01](#));
- agricultural water conservation system ([A.R.S. § 43-1084](#));
- contributions to qualifying charitable organizations ([A.R.S. § 43-1088](#));
- contributions to qualifying foster care organizations ([A.R.S. § 43-1088](#));
- corporate contributions to STOs ([A.R.S. §§ 43-1183, 43-1089.04](#));
- corporate contributions to STOs for disabled or displaced students ([A.R.S. §§ 43-1184, 43-1089.04](#));
- dependent tax ([A.R.S. § 43-1073.01](#));
- donations to the military family relief fund ([A.R.S. § 43-1086](#));
- employing National Guard members ([A.R.S. § 43-1079.01](#));
- employment of TANF recipients ([A.R.S. § 43-1175](#));
- entity level income taxes paid ([A.R.S. §§ 43-1014, 43-1077](#));
- family income tax ([A.R.S. § 43-1073](#));
- healthy forest production ([A.R.S. § 43-1076.01](#));
- income taxes paid to other states or countries ([A.R.S. § 43-1071](#));
- increased excise taxes paid ([A.R.S. § 43-1072.01](#));
- investment in qualified small businesses credit ([A.R.S. § 43-1074.02](#));
- motion picture production costs ([A.R.S. §§ 43-1082, 43-1165](#));
- new employment ([A.R.S. § 43-1074](#));

- pollution control equipment ([A.R.S. § 43-1170](#));
- private STO “original” credit ([A.R.S. § 43-1089](#));
- private STO “switcher” credit ([A.R.S. § 43-1089.03](#));
- property tax ([A.R.S. § 43-1072](#));
- public school fees and contributions ([A.R.S. § 43-1089.01](#));
- qualified facilities ([A.R.S. §§ 43-1083.03, 43-1164.04](#));
- renewable energy production for self-consumption ([A.R.S. § 43-1164.05](#));
- renewable energy production ([A.R.S. §§ 43-1083.02, 43-1164.03](#));
- research and development ([A.R.S. §§ 43-1074.01, 43-1168](#));
- research and development for university research ([A.R.S. §§ 43-1074.01\(A\)\(1\)\(c\), 43-1168\(A\)\(1\)\(d\)](#));
- school site donation ([A.R.S. §§ 43-1089.02, 43-1181](#));
- solar energy device ([A.R.S. § 43-1083](#)); and
- taxes paid for coal consumed in generating electrical power ([A.R.S. § 43-1178](#)).

Of these, nine are refundable income tax credits. See [A.R.S. §§ 43-1072](#) (property tax credit), [43-1072.01](#) (increased excise taxes paid credit), [43-1083.03](#) (individual qualified facilities credit), [43-1083.02](#) (individual renewable energy industry credit), [43-1074.01\(C\)](#) (individual research and development credit), [43-1165](#) (motion picture production costs credit), [43-1164.04](#) (corporate qualified facilities credit), [43-1164.03](#) (corporate

renewable energy industry credit), [43-1168\(D\)](#) (corporate research and development credit).

Accepting Plaintiffs’ theory that tax credits are gifts would expose all of these tax credits to constitutional scrutiny, upending Arizona’s tax framework and flooding the courts with litigation. Take Arizona’s increased excise taxes paid credit, which is refundable. [A.R.S. § 43-1072.01\(D\)](#). It provides tax relief for lower income-earners by mitigating sales tax increases. [A.R.S. § 43-1072.01\(A\)–\(B\)](#). Since 2001, the Department of Revenue has applied this credit over 13 million times, providing needy taxpayers with over \$600 million in relief. Office Econ. Rsch. & Analysis, Ariz. Dep’t Revenue, *Arizona’s Individual and Corporate Income Tax Credit Report* 36 (Nov. 19, 2025).

Plaintiffs’ theory that differential tax treatment implicates the Gift Clause would also threaten Arizona’s 16 transaction-privilege tax (“TPT”) classifications:

- retail ([A.R.S. § 42-5061](#));
- transporting ([A.R.S. § 42-5062](#));
- utilities ([A.R.S. § 42-5063](#));
- telecommunications ([A.R.S. § 42-5064](#));

- publication ([A.R.S. § 42-5065](#));
- job printing ([A.R.S. § 42-5066](#));
- pipeline ([A.R.S. § 42-5067](#));
- private car line ([A.R.S. § 42-5068](#));
- commercial lease ([A.R.S. § 42-5069](#));
- transient lodging ([A.R.S. § 42-5070](#));
- personal property rental ([A.R.S. § 42-5071](#));
- mining ([A.R.S. § 42-5072](#));
- amusement ([A.R.S. § 42-5073](#));
- restaurant ([A.R.S. § 42-5074](#));
- prime contracting ([A.R.S. § 42-5075](#)); and
- online lodging marketplace ([A.R.S. § 42-5076](#)).

Consider the commercial-lease TPT classification. Persons engaging in commercial-lease activity pay a 0% TPT rate, rather than the standard 5% rate imposed on restaurants, retail stores, newspapers, and construction companies. [A.R.S. §§ 42-5069, 42-5010\(A\)\(1\), \(4\)](#). By Plaintiffs' logic, this lower TPT for commercial leases would implicate the Gift Clause because the state has forgone the collection of tax revenue by not taxing commercial-lease activity.

Or consider the other sectors of the economy from which the legislature decided to forgo imposing the standard 5% TPT. [A.R.S. § 42-](#)

[5010\(A\)\(1\)](#). The benefited industries include healthcare, banking, insurance, law, accounting, architecture, engineering, education, childcare, and farming. *Id.* If the Gift Clause applies to uncollected tax revenue, as Plaintiffs claim, all of these exemptions would be vulnerable to constitutional attack.

Charitable deductions would be at risk, too. As the Supreme Court explained in *Kotterman*, there is “no constitutional difference between a [tax] credit and a deduction.” [193 Ariz. at 288, ¶ 50](#). If credits were appropriations of public money, then deductions would be too, with courts “forced to rule that deductions for charitable contributions ... [are] unconstitutional[.]” *Id.*

Take deductions for donations to religious entities. Arizona’s itemized state deductions mirror the federal deductions. [A.R.S. § 43-1042\(A\)](#). The federal Internal Revenue Code, in turn, permits a deduction for a “charitable contribution” to 501(c)(3) nonprofits like churches. [26 U.S.C. § 170\(c\)](#). But if credits (and thus deductions) were appropriations, then allowing taxpayers to take a charitable deduction for donating to their churches would send public money to religious establishments. That would violate [article 2, § 12 of the Arizona Constitution](#), which says that “[n]o public money ... shall be appropriated for or applied to any religious worship, exercise, or instruction, or to the support of any religious establishment.”

True, “Arizona’s framers did not hesitate to extend tax-exempt status to churches” and in fact “uniformly supported property tax exemptions for all ‘religious associations or institutions not used or held for profit.’” *Kotterman*, 193 Ariz. at 287, ¶ 43 (quoting Ariz. Const. art. 9, § 2(2)). But one logical inference from that fact is that “the framers did not regard such tax-saving measures as direct grants of ‘public money’” in the first place. *Id.*

They are not, and this Court need not “make judgments about the overall wisdom of the tax credit That obligation falls to the other branches of government.” *Id.* at 288, ¶ 48. The Court should follow *Kotterman* and refuse to upend Arizona tax policy, open the courts to challenges of every credit and classification, and jeopardize longstanding incentives for donations to religious and educational organizations.

II. Even if tax credits implicate the Gift Clause, this Court should not decide the Program’s constitutionality on a motion-to-dismiss record.

Plaintiffs do not stop at asking the Court to reverse the dismissal and hold that tax credits implicate the Gift Clause. They urge the Court (OB ep 35–45) to take a leap and declare these specific credits unconstitutional. But this case is here on a Rule 12(b)(6) dismissal, with no answers, no discovery, no findings, and without Defendants’ having presented a defense beyond

the narrow motion practice below. Consequently, even if the Court holds that the Gift Clause applies, then the proper course is a remand, not a constitutional ruling on the pleadings.

A Rule 12(b)(6) appeal asks one question: whether the well-pleaded facts, taken as true, state a claim. Nothing in that posture puts the merits before this Court. Plaintiffs never asked the superior court to make a final ruling on the merits. Nor could they have done so. Defendants have not even filed answers to the complaint. There has been no summary-judgment motion, no trial on the merits, not even a Rule 12(c) motion for judgment on the pleadings. There is no final ruling on the merits for this Court to review.

“‘[A] court of appeals sits as a court of review, not of first view.’” *City of Flagstaff*, 255 Ariz. at 14, ¶ 26. The superior court must have the chance to “resolve all legal and factual matters before it in the first instance.” *Id.* at 15, ¶ 28. Plaintiffs acknowledged to the superior court that analyzing adequate consideration under the Gift Clause would likely require discovery. [ROA 57 ep 12 n.12.] Defendants are entitled to complete discovery and present evidence on why the Program complies with the Gift Clause. Until Defendants have had that opportunity and the superior court has ruled on

the merits, appellate review of this question is premature. *City of Flagstaff*, 255 Ariz. at 15, ¶ 28.

When a complaint survives a motion to dismiss, the case returns to the trial court for further proceedings. *See, e.g., Roberts v. State*, 253 Ariz. 259, 271, ¶ 47 (2022) (reversing dismissal and remanding for further proceedings); *Coconino County v. Antco, Inc.*, 214 Ariz. 82, 91, ¶ 27 (App. 2006) (same); *Rashedi v. Gen. Bd. of Church of Nazarene*, 203 Ariz. 320, 326, ¶ 29 (App. 2002) (same). If this Court rules that tax credits implicate the Gift Clause, then the superior court may adjudicate in the first instance whether the Program violates the Gift Clause after Defendants have presented their defense on the merits.

III. Plaintiffs cannot obtain a permanent injunction because they have not prevailed on the merits.

In a similarly premature request, Plaintiffs ask this Court (OB ep 52) to permanently enjoin the Program. That, too, is premature because an injunction could issue only if Plaintiffs prevail on the merits, which they have not done.

Plaintiffs appear to ask this Court to enter a *permanent* injunction. They cite (OB ep 52) *Brown v. City of Phoenix*, which sets “the standard for a party

to obtain a permanent injunction,” not a preliminary injunction. 258 Ariz. 302, 308, ¶ 17 (App. 2024). In addition, the word “preliminary” never appears in Plaintiffs’ argument for an injunction (OB ep 52–55).⁴ The Court should deny this premature request for extraordinary relief. The superior court has not yet adjudicated whether permanent injunctive relief should be granted. Again, this is “a court of review, not of first view.” *City of Flagstaff*, 255 Ariz. at 14, ¶ 26. The superior court has not adjudicated the issue because Plaintiffs have not asked for a permanent injunction yet. They could not yet have asked for a permanent injunction (apart from listing it in the complaint) because the superior court has not made a final adjudication on the merits.

“[O]btain[ing] a permanent injunction under Arizona law requires a showing that: [] the plaintiff prevailed on the merits[.]” *Brown*, 258 Ariz. at 308, ¶ 17. Here, all that has happened is that the superior court granted a

⁴ To the extent Plaintiffs do seek review of the superior court’s denial of a preliminary injunction, that issue is moot because the superior court “subsequently dismissed Plaintiffs’ claims.” *Koppula v. Jaddou*, 72 F.4th 83, 84 (5th Cir. 2023). “[T]here is no need for a preliminary injunction to preserve the status quo during the pendency of trial court proceedings that are now over.” *Id.* If the Court reverses the dismissal, then it should remand to the superior court for further proceedings. Plaintiffs may then renew their request for a preliminary injunction.

Rule 12(b)(6) dismissal and denied a motion for preliminary injunction as moot. [ROA 77 ep 7.] There has been no trial or other final adjudication on the merits. Plaintiffs have not “prevailed on the merits” and cannot obtain a permanent injunction in this posture. *Brown*, [258 Ariz. at 308](#), ¶ 17.

IV. Plaintiffs lack taxpayer standing.

In any event, Plaintiffs cannot establish taxpayer standing to challenge the Program’s tax credits in the first place. Although the superior court did not reach this issue, this Court may affirm dismissal “if it is correct for any reason.” *Old Republic*, [224 Ariz. at 530](#), ¶ 19.

The Declaratory Judgments Act “does not permit courts to act as legislators by setting policy or issuing advisory opinions—standing is still required.” *Ariz. Creditors Bar Ass’n, Inc. v. State*, [257 Ariz. 406, 410](#), ¶ 12 (App. 2024). “[D]eclaratory relief should be based on an existing state of facts, not those which may or may not arise in the future.” *Id.* A plaintiff must allege a “distinct and palpable injury” rather than a generalized publicly shared grievance to establish standing. *Sears v. Hull*, [192 Ariz. 65, 69](#), ¶ 16 (1998).

Arizona’s doctrine of taxpayer standing traces to *Ethington v. Wright*, [66 Ariz. 382](#) (1948), which recognized that taxpayers may enjoin the illegal expenditure of public funds. The rationale is grounded in the taxpayers’

equitable ownership of funds already in the state treasury and their corresponding liability to replenish that treasury after any misappropriations. *Id.* at 386. Two things must therefore be true before a taxpayer can invoke this doctrine: there must be (1) public funds and (2) the threat of their misappropriation. *Id.*

But tax credits are not appropriations or expenditures of public money. Again, in *Kotterman*, the Court held that “a tax credit” is not “public money,” “an appropriation,” “equivalent to spending,” or a “gift.” 193 Ariz. at 285, 287–88, ¶¶ 40, 45, 50, 52. The state simply “forgoes revenues that it could have chosen to collect in the future.” *Maricopa County*, 187 Ariz. at 280. The state cannot misappropriate those revenues because it does not own them. And taxpayers lack standing to sue the state over funds the state does not own. *Ethington*, 66 Ariz. at 386.

Welch v. Cochise County Board of Supervisors, 251 Ariz. 519 (2021), confirms this result. There, the plaintiff challenged the appointment of a justice of the peace and claimed taxpayer standing because the appointee’s salary was paid from tax revenues. *Id.* at 522–23, ¶¶ 6, 9. The Court held the connection “too remote” and “incidental.” *Id.* at 525, ¶ 19. No additional money left the treasury to pay the challenged appointee. *Id.* The implication

of a taxpayer-funded source alone could not establish standing. *Id.* at 524, ¶ 17. Such a test would be “meaningless” because virtually every government action has at least some impact on taxpayer funds. *Id.*

Plaintiffs’ connection to the Program credit is just as remote as the connection *Welch* rejected. Plaintiffs’ sole theory of injury is that they “will bear a share of the burden for replenishing state coffers.” [ROA 1 ep 20, ¶ 146.] But this theory would justify standing to challenge any legislative policy decision that reduces tax revenues—the enactment of credits, deductions, and exemptions and even the reduction of tax rates. *Welch*, 251 *Ariz.* at 524, ¶ 17. Sharing the burden of replenishing state coffers, without more, is an “incidental” and “meaningless” connection. *Id.* That is not enough to establish taxpayer standing. *Id.*

Nor have Plaintiffs pled facts showing that the Program credit has resulted in funds leaving the treasury. For their facial challenge, Plaintiffs did not allege that every application of the Program credit will result in a refund. [ROA 1 ep 18–20, ¶¶ 125–47.] Plaintiffs also did not allege that either MoPic-2023-008 or MoPic-2024-004 has resulted or will result in a refund. [COA-*Id.* ep 20–21, ¶¶ 148–58.] And even if applicants for the Program credit

were entitled to refunds, Plaintiffs allege that applicants may receive a credit voucher, which would eliminate any refund. [COA-*Id.* ep 14, ¶ 93.]

To the extent that an actual refund would draw money from the treasury and thereby create standing, Plaintiffs' theory fails for a separate reason: the harm they describe is hypothetical. Whether any particular credit results in a refund depends on the recipient's total tax liability, the application of other credits and deductions, whether the credit completes the multi-step post-approval process, and whether the required CPA verification is obtained. [COA-*Id.* ep 12, 16, ¶¶ 72, 109.] These conjectural future events cannot support standing. *See Ariz. Creditors Bar Ass'n*, [257 Ariz. at 410, ¶ 12](#).

The statutory caps — \$75 million in 2023, \$100 million in 2024, and \$125 million thereafter — do not help Plaintiffs either. Those caps limit the amount by which the state may decrease tax revenue each year by operating the Program. [A.R.S. § 41-1517\(I\)](#). These are limits, not expenditures.

Plaintiffs are taxpayers who object to a tax credit. But objecting to a legislative policy choice is not the same as suffering a cognizable injury. Tax credits are not public money. *Kotterman*, [193 Ariz. at 285, 287–88, ¶¶ 36, 40, 45, 50, 52](#). The state cannot misappropriate what it does not own. *Id.*;

Ethington, 66 Ariz. at 386. And a generalized claim that the Program will have “some impact on taxpayer funds” is not enough to establish standing. *Welch*, 251 Ariz. at 524, ¶ 17. The Court should affirm the dismissal on this alternative ground.

CONCLUSION

This Court should affirm.

RESPECTFULLY SUBMITTED this 27th day of May, 2026.

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/s/ Eric M. Fraser

Eric M. Fraser

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I hereby certify that on the 27th day of May, 2026, the foregoing Answering Brief was served via the Court's E-Filer system and a copy served via email to:

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