ARIZONA COURT OF APPEALS
DIVISION TWO

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

BRIEF OF AMICUS CURIAE THE ARIZONA FREE ENTERPRISE CLUB AND GRAND CANYON LEGAL CENTER IN SUPPORT OF PLAINTIFFS-APPELLANTS

(Filed with the Written Consent of All Parties)

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INTEREST OF AMICUS CURIAE[1]

Amicus Arizona Free Enterprise Club is an Arizona nonprofit social welfare corporation that engages in public education and advocacy in support of free markets, limited government, and economic growth in the State of Arizona.

Amicus Grand Canyon Legal Center is a project of the AZ Liberty Network, an Arizona charitable organization that is focused on increasing public knowledge and civic participation with respect to social, cultural and economic issues affecting Arizona. The Grand Canyon Legal Center was established to champion in civil litigation constitutional rights and structural limitations on government power.

The Arizona Gift Clause vindicates individual rights, the rule of law, government accountability, and the integrity of the public fisc by prohibiting government actors from misappropriating taxpayer-owned resources to enrich favored private interests. The proper construction and rigorous application of this constitutional safeguard is central to the both Amici's organizational missions.

INTRODUCTION AND SUMMARY OF ARGUMENT

"What's in a name? That which we call a rose [] By any other name would smell as sweet." *Moore v. Smotkin*, 79 Ariz. 77, 79 (1955) (quoting William

[1] Pursuant to ARCAP 16, amicus states that no party or party's counsel authored this brief in whole or in part, and that no person other than amicus and its counsel contributed money intended to fund the preparation or submission of this brief.

Shakespeare, Romeo and Juliet act 2, sc. 2). Just as in Shakespeare's time, so too in ours: one might call a thing by a different name, but the thing remains what it is. What the Arizona Motion Picture Production Program (the "Program") calls a tax credit is, in reality, a direct subsidy of public funds to private actors without adequate consideration for the gift.

The Program—codified at A.R.S. §§ 41-1517, 43-1082, and 43-1165—authorizes up to $125 million annually in refundable tax credits to film production companies. Although its financial benefits are labeled "tax credits," the bottom line is that when a participant's credit exceeds its tax liability, the State cuts a check: the excess "shall be paid to the taxpayer in the same manner as a refund under § 42-1118." A.R.S. §§ 43-1082(F), 43-1165(F). Unlike general tax exemptions, deductions, or non-refundable credits, the Program provides an appropriation of state funds to a narrow class of private actors, and it does so without receiving proportionate (or, arguably, any) consideration in return for that expenditure.

The Arizona Constitution's Gift Clause prohibits the State from making "any donation or grant, by subsidy or otherwise, to any individual, association, or corporation." Ariz. Const. art. IX, § 7.

A century ago, the Arizona Supreme Court explained the purpose behind this constitutional prohibition: the Gift Clause "was designed primarily to prevent the use of public funds raised by general taxation in aid of enterprises apparently devoted

to quasi public purposes, but actually engaged in private business." *Turken v. Gordon*, 223 Ariz. 342, 346 ¶ 10 (2010) (*quoting Day v. Buckeye Water Conservation & Drainage Dist.*, 28 Ariz. 466, 473 (1925)); *see also Schires v. Carlat*, 250 Ariz. 371, 374 ¶ 6 (2021) ("In a nutshell, the evil to be avoided was the depletion of the public treasury or inflation of public debt by a public entity engaging in non-public enterprises, by giving advantages to special interests." (alterations adopted; citation omitted)).

The superior court dismissed Plaintiffs' challenge, reasoning that *Kotterman v. Killian*, 193 Ariz. 273 (1999), categorically removes anything labeled a "tax credit" from the Gift Clause's reach. In doing so, the superior court erroneously elevated form over substance, turning *Kotterman*'s analysis of a non-refundable $500 credit for contributions to charitable organizations funding children's education—under which no dollar ever left the treasury—into a blanket grant of immunity for a $125 million-a-year program directly subsidizing film production companies.

But *Kotterman* itself contradicts that approach: it affirmed that "the constitutionality of a tax benefit 'does not turn … on the label we accord it.'" *Id.* at 279 ¶ 13 (citation omitted). And since then, the Supreme Court has continued to admonish that "in all Gift Clause cases, courts must probe the reality of the transaction." *Gilmore v. Gallego*, 258 Ariz. 38, 46 ¶ 34 (2024).

The decision below overlooked two critical distinctions—distinctions which also provide the limiting principles to answer Defendants' warnings about upending Arizona tax policy. The first is the distinction between (1) ordinary tax exemptions, deductions, and non-refundable credits that merely reduce liability—mechanisms that confer no benefit beyond negating what is owed—and (2) refundable credits, like those here, which can operate as direct transfers of public money in excess of what a taxpayer owes. The second is the distinction between refundable credits that are broadly available to the taxpaying public and those, like the Program's, reserved for an extremely narrow class of favored enterprises.

The Program falls on the wrong side of both distinctions and fails the Gift Clause analysis. Neither *Kotterman*, nor a century of Gift Clause jurisprudence immunizes the Program from scrutiny under these principles.

ARGUMENT

The Arizona Supreme Court has "adopted a two-pronged test . . . to determine whether a public entity has violated the Gift Clause." *Schires*, 250 Ariz. at 374 ¶ 7. "First, a court asks whether the challenged expenditure serves a public purpose." *Id.* "If a public purpose exists, the court secondarily asks whether 'the value to be received by the public is far exceeded by the consideration being paid by the public.'" *Id.* at 375 ¶ 7 (citation omitted). "If so, the public entity violates the Gift Clause by 'providing a subsidy to the private entity.'" *Id.* (citation omitted).

Defendants argue that tax credits categorically do not implicate the Gift Clause. AB at 10. But that is wrong as to a key feature of the Program: the credits' refundability. And subjecting the Program to Gift Clause scrutiny threatens none of the credits, deductions, or other classifications Defendants list in their parade of horribles because the two distinctions identified above—refundability and narrowness of the benefitted class—do the sorting work the Constitution requires.

I. The Program's Refund Component Is An Expenditure Of Public Money.

A. A Refund Check Is Paid From Money The State Indisputably Owns.

The Gift Clause's prohibition is broad and categorical: the state shall not "ever . . . make any donation or grant, *by subsidy or otherwise*." Ariz. Const. art. IX, § 7 (emphasis added). By its plain language ("or otherwise"), the Gift Clause is not limited to direct appropriations. Arizona courts have long struck down other forms of subsidy, including the conferral of indirect or non-monetary benefits on private entities. *See, e.g.*, *Rowlands v. State Loan Bd.*, 24 Ariz. 116, 123 (1922) (holding that forgiveness of interest on state loans violated the Gift Clause); *Neptune Swimming Found. v. City of Scottsdale*, 256 Ariz. 551, 560 ¶¶ 28–29 (2024) ("The framers did not restrict their prohibition [in the Gift Clause] to the grant of public money." (quoting *Ariz. Ctr. for L. in the Pub. Int. v. Hassell*, 172 Ariz. 356, 367 (App. 1991))).

Here, this Court need not probe the outer boundaries of "or otherwise" to resolve this case because the Program's refund component is a subsidy even under Defendants' own cramped definitions. Defendants argue, from 1910 dictionaries, that "gift," "donation," "grant," and "subsidy" each "entails a party's transferring something that it owns," AB at 28, and that the State does not own untaxed taxpayer income.

That's fair enough as to untaxed income. But consider what actually happens under this Program. Suppose a participant's tax liability would have been $100,000, and it claims a $200,000 credit through the Program. The State issues the participant a payment of $100,000. A.R.S. §§ 43-1082(F), 42-1118(A)(1). That $100,000 payment could not possibly have been "in the taxpayer's ownership" before the return was processed. *Cf. Kotterman*, 193 Ariz. at 285 ¶ 40.

It was never the participant's "income," taxed or untaxed. Indeed, *it did not belong to the participant at all* until the State cut the participant a check. It was money in the State treasury, collected from other taxpayers, and transferred to the participant under the label of a refundable tax credit. That is a payment of public money to a private business, plain and simple—a "grant" or "subsidy" under any reasonable definition, and at the very least an "otherwise" conferred public benefit within the sweep of the Gift Clause's prohibition.

Thus, *Kotterman*'s maxim— that "[o]ne cannot make a gift of something that one does not own," 193 Ariz. at 288 ¶ 52—directly undercuts Defendants' position here. The State *does* own the funds in its treasury. When it disburses those funds to a film production company beyond any liability that a company ever would have owed, it gives away something it owns. Indeed, *Neptune Swimming* recently confirmed the limit of *Kotterman*'s rationale rather than extending it: the Court there described *Kotterman* as "reason[ing] 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 (emphasis added). A refund payment above and beyond any tax liability is fundamentally different from foregone collection of taxes otherwise owed.

B. Fiscal Authorities Uniformly Treat The Refundable Portion Of Refundable Credits As Spending, Not Foregone Revenue.

The practical reality that a refund is an expenditure is not Taxpayers' or Amici's characterization alone. It is how governments consistently account for refundable credits.

The Congressional Budget Office recognizes that refundable credits are "subsidies delivered through the tax system" that "could alternatively be provided through spending programs," and that the "choice between using the tax system and relying on spending programs hinges largely on administrative considerations, such

as the effectiveness in reaching the target population, timeliness, and the ability to ensure compliance with rules." Congressional Budget Office, *Refundable Tax Credits* (Jan. 24, 2013).[2] "Both congressional budget agencies and the executive branch record the refundable portion of refundable credits as spending or outlays." Gordon Gray, *Reassessing the Budgetary Treatment of Refundable Tax Credits*, American Action Forum (Mar. 9, 2023).[3] Accordingly, refundable credits are "the equivalent of a direct expenditure program" because they provide cash payments to taxpayers with no liability. Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy*, 83 Harv. L. Rev. 705, 723–24 (1970).

To be clear, this is not merely a matter of "economic theory" or fact-intensive economic analysis. *See* 193 Ariz. at 285–86 ¶¶ 41–42 ("Modern economic theory, under some circumstances, may be helpful to our understanding. As has been shown, however, it does not necessarily govern constitutional interpretation.").

The point here is narrower than that and is a straightforward matter of arithmetic and logic: when the credit exceeds a taxpayer's liability, public money leaves the treasury. The State cuts a check, and that check comes from the public fisc, not from the recipient's own funds. Because the Program authorizes government payments to private recipients, it is subject to the Gift Clause.

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[2] https://www.cbo.gov/publication/43767.
[3] https://www.americanactionforum.org/research/reassessing-the-budgetary-treatment-of-refundable-tax-credits/.

C. *Kotterman* Did Not Address Refundable Tax Credits.

The superior court elided the refundable/non-refundable distinction by reasoning that *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. But *Kotterman* did *not* address this issue. The paragraph the superior court relied on responded to the dissent's "concern over 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." 193 Ariz. at 287 ¶ 48; *see also id.* at 309–10 ¶ 148 n.17 (Feldman, J., dissenting) (speculating that a taxpayer could "receive[] a dollar-for-dollar refund" of an STO contribution from the state while also "reporting the contribution as a charitable deduction on the federal income tax return").

The concern that scenario highlights—stacking of a state credit and a federal deduction—is fundamentally different from a refundable credit that results in a cash payment from the State, exceeding any state tax the recipient ever owed. Indeed, the dissent's hypothetical does not involve refundable credits at all: a federal charitable deduction merely reduces taxable income; it cannot result in a payment of money from the federal government (let alone the state government) to the taxpayer unless the taxpayer had overpaid its federal taxes throughout the year.

The "profit" that *Kotterman* deemed "a policy matter for the legislature," *id.* at 287–88 ¶ 48, was an incidental product of the interaction between state and federal

tax codes—not a check drawn on the Arizona treasury for more than the recipient's Arizona liability. This case involves the latter scenario, and nothing in *Kotterman* authorizes it.

Understanding what the *Kotterman* program actually did underscores why its reasoning cannot stretch to cover this one. Participants in the STO program were not enriched; the tax credit merely reduced a participant's tax liability. Specifically, allowed them to direct some of their funds to benefit charitable non-profit scholarship organizations rather than paying those funds into the public coffers. "[N]o money ever enter[ed] the state's control as a result of th[e] tax credit," 193 Ariz. at 285 ¶ 36, and no money ever left the treasury. Every credited dollar merely offset liability otherwise owed.

Under the Program, by contrast, the State makes the "[i]mportant decisions" from beginning to end, *cf. id.* at 281 ¶ 19—the Arizona Commerce Authority determines eligibility and pre-approves film productions, A.R.S. § 41-1517(C), (G); the amount of the benefit is calculated from the participant's private production costs following post-approval, A.R.S. § 41-1517(H); and if the credit exceeds liability, the Arizona Department of Revenue ("Department") pays the difference from the treasury, A.R.S. §§ 43-1082(F), 42-1118(A).

The state action *Kotterman* found absent is the Program's entire architecture. And the "evils" the *Kotterman* Court found absent—the "extravagant dissipation of

public funds by government in subsidizing private enterprises . . . in the guise of public interest," 193 Ariz. at 288 ¶ 52 (cleaned up)—are part of the Program's express design.

Relatedly, Defendants err in recasting *Maricopa County v. State*, 187 Ariz. 275 (App. 1996), and *Pimalco, Inc. v. Maricopa County*, 188 Ariz. 550 (App. 1997), as standing for a purely temporal rule: retroactive tax legislation implicates the Gift Clause; prospective legislation never does. AB at 51–53.

The operative distinction those cases drew is functional, not merely temporal. In the first category, "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*, 187 Ariz. at 280. In the second, "the taxing entity modifies its laws to impose on itself *an obligation to refund revenues that it collected lawfully in the past"*—and that "constitutes a transaction that implicates the Gift Clause." *Id.* (emphasis added).

Every refund dollar disbursed under the Program is precisely that: revenue lawfully collected in the past—from other taxpayers—and paid out of the treasury. The date on which the Legislature enacted the credit does not change the source of the funds when the State issues the check.

The key to *Maricopa County* was the affirmative payment of money the state held, as opposed to foregone collection. So too here. To the extent the Program

merely reduces a participant's liability, it may resemble Defendants' first category; but to the extent it obligates the State to write checks, it falls squarely within the second, and the Gift Clause is implicated. *See id*.

II. Applying The Gift Clause Here Threatens None Of The Credits, Deductions, Or Classifications Defendants Catalog.

Defendants devote much of their brief to a parade of horribles: listing a host of income tax credits, transaction-privilege tax classifications, and charitable deductions for donations to churches and schools that they claim would face constitutional attack if Taxpayers' challenge prevails. AB at 60–66. These concerns are misplaced.

First, virtually everything on Defendants' list involves foregone collection, not a direct payment from the public fisc under the guise of a refundable credit. Non-refundable credits, deductions, exemptions, and differential TPT classifications reduce what a taxpayer owes; they do not result in the government actually paying anyone anything.

Second, even as to the handful of refundable credits Defendants identify, the breadth of the recipient class matters. Consider Defendants' lead example, the increased excise taxes paid credit, A.R.S. § 43-1072.01, which Defendants indicate has been applied "over 13 million times, providing needy taxpayers with over $600 million in relief." AB at 63.

A modest, broadly available credit providing relief to a wide class of individual taxpayers is fundamentally different from the special-interest subsidy the Gift Clause quintessentially targets. The Program is the latter: a $125,000,000 annual authorization, awarded case-by-case to hand-picked companies in a single industry. That's precisely the kind of narrowly targeted handout the Gift Clause was designed to prevent. *See Indus. Dev. Auth. v. Nelson*, 109 Ariz. 368, 372 (1973) ("These provisions were designed to prevent the economic losses of the 19th century suffered by municipal corporations which gave money, credit or other valuable advantages to railroads, canal companies, etc.").

Third, Defendants' warnings overlook the fact that merely subjecting a transaction to Gift Clause scrutiny does not necessarily condemn it. *Maricopa County* applied the Gift Clause and found no violation. 187 Ariz. at 281. So did *Pimalco*, 188 Ariz. at 561. Being subject to Gift Clause scrutiny is not a death-knell from tax schemes that do not violate it. It is only a problem for those which, like the Program here, provide a subsidy to a narrow set of private entities with inadequate (or no) benefit to the public.

III. The Program Is The Paradigmatic Situation The Gift Clause Was Designed To Prevent.

A. The State Receives No Quantifiable Consideration For The Program's Subsidies.

Because the Gift Clause applies, the Program must serve a public purpose and be supported by adequate consideration. *Schires*, 250 Ariz. at 374–75 ¶ 7. The consideration inquiry "focuses on what the public is giving and getting from an arrangement and then asks whether the 'give' so far exceeds the 'get' that the government is subsidizing a private venture in violation of the Gift Clause." *Id.* at 376 ¶ 14 (citation omitted). The gross disparity between "give" and "get" here is the Program's most obvious failure.

The State does not receive any quantifiable consideration for the Program's subsidies—save perhaps an acknowledgment in the closing credits that a film was shot or produced in Arizona. A.R.S. § 41-1517(B)(1)(b)(3). That is not enough.

Likewise, hopes of future tax revenues and economic development—without any enforceable commitment—are not adequate under the Gift Clause. *See Schires*, 250 Ariz. at 377 ¶ 16 (explaining an "anticipated indirect benefit" is "valueless" for purposes of the consideration prong). And the value of a closing-credits acknowledgment is impossible to quantify, which the consideration prong requires. *See id.* at 376 ¶ 14 ("Analysis of adequacy of consideration for Gift Clause purposes

focuses on the objective fair market value of what the private party has promised to provide in return for the public entity's payment." (cleaned up)). A participant's promise to conduct its own for-profit business in Arizona adds nothing, because a "promise[] to engage in their respective private businesses" is insufficient consideration under the Gift Clause. *See id.* at 377–78 ¶¶ 16.

B. Industry-Specific Subsidies Distort Markets And Reward Political Connections—The Modern Face Of The Railroad Subsidies The Framers Targeted.

The Gift Clause "represents the reaction of public opinion to the orgies of extravagant dissipation of public funds by counties, townships, cities, and towns in aid of the construction of railways, canals, and other like undertakings during the half century preceding 1880." *Turken*, 223 Ariz. at 346 ¶ 10 (quoting *Day*, 28 Ariz. at 473). The problem was not merely fiscal costs; it was also favoritism—the injustice of "giving advantages to special interests." *Schires*, 250 Ariz. at 374 ¶ 6 (citation omitted).

Selective refundable credits to a single industry revive that evil in modern dress. When the State subsidizes one class of enterprises, it necessarily disadvantages every unsubsidized competitor for labor, land, and capital—including countless Arizona small businesses whose taxes fund the Program's refund checks, and who are themselves excluded from any such benefits.

And because the Program's benefits flow through a pre-approval process administered by a state authority, with an annual pool capped at $125 million, A.R.S. § 41-1517(I), the practical beneficiaries are the large, sophisticated, politically connected production companies, which are best positioned to navigate that process and capture the capped allocation—at the expense of smaller independent entities and of the taxpaying public generally. That is precisely the "use of public funds raised by general taxation in aid of enterprises . . . actually engaged in private business" that the framers forbade. *Day*, 28 Ariz. at 473.

C. The Legislature Itself Long Resisted Film Subsidies For Exactly These Reasons—And Other States Have Retreated From Them.

The deference Defendants invoke, AB at 32–36, assumes the Program reflects the Legislature's settled tax-policy judgment. The history is otherwise. Prior to the Program's enactment, the Arizona Legislature passed but *declined to extend* film production credits, in substantial part because of concerns that such credits operate as subsidies with poor returns to the public. *See* Arizona Free Enterprise Club, *Film Tax Credits Skepticism Should Carry Over to Other Credits* (Dec. 15, 2010) ("It's rare when a state program ends. But a bit of good news occurred last year in the

legislature when Arizona lawmakers refrained from extending the dismal motion picture tax credit . . . .")[4].

Nor is Arizona's experience unique. *See generally* Amicus Brief of the Pelican Institute. And many other states that adopted film production incentives have scaled them back or eliminated them after studies showed that such programs return only a fraction of each dollar expended. *See* Arizona Free Enterprise Club, *Film Tax Credits Skepticism Should Carry Over to Other Credits* (Dec. 15, 2010) ("In Michigan, jobs created by their film tax credit cost the state $193,000 each, thereby causing the governor-elect to re-examine the program. Film credits have been scaled back in Wisconsin, capped in Rhode Island, and suspended in New Jersey, Iowa and Kansas.").

This history matters for two reasons. *First*, applying the Gift Clause here does not disturb a century of settled legislative tax design; it addresses a subsidy the Legislature itself abandoned years ago and then recently resurrected. *Second*, it corroborates the consideration analysis above: jurisdictions that have measured what the public actually "gets" from film subsidies have repeatedly concluded that the get is a small fraction of the give.

[4] https://azfree.org/blog/2010/12/15/film-tax-credits-skepticism-should-carry-over-to-other-credits/

CONCLUSION

Substance trumps labels. However it may be styled, the refundable portion of the Program is a direct appropriation of public funds to private enterprises, masquerading as tax relief. And the Program as a whole confers valuable, state-created benefits on a narrow, favored class without proportionate public return. Distinguishing between mechanisms that merely diminish extant tax liability (as in *Kotterman*) and refundable credits that transfer public money is essential. That distinction, together with the breadth of a credit's beneficiary class, fully answers Defendants' warnings about other Arizona tax provisions. Nothing exempts the Program from the Gift Clause's reach.

The judgment below should be reversed and the case remanded so that the Program may be subjected to full Gift Clause analysis, under which it cannot survive.

RESPECTFULLY SUBMITTED this 6th day of August, 2026.

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CERTIFICATE OF COMPLIANCE

Pursuant to ARCAP 4 and 16, undersigned counsel certifies that this brief uses proportionately spaced 14-point Times New Roman type, is double-spaced, and contains 3,894 words (exclusive of the caption, tables, signature block, and certificates).

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