SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2025-001929 11/10/2025

HONORABLE ADELE PONCE

CLERK OF THE COURT
J. Zinkowich
Deputy

DEBORAH MCEWEN, et al. PARKER JACKSON

v.

BOARD OF DIRECTORS OF THE ARIZONA COMMERCE AUTHORITY, et al. ANDREW GEORGE PAPPAS

SCOT G TEASDALE
JUDGE PONCE

RULING

The Court heard argument on the request by Deborah McEwen and Jan Mittelstaedt ("Plaintiffs") for a preliminary injunction preventing the Board of Directors of the Arizona Commerce Authority ("ACA") and the Arizona Department of Revenue ("ADOR") (together "Defendants") from processing tax credit subsidies claimed through the Arizona Motion Picture Production Program ("the Program") and from issuing related payments. The Court considered the motion as well as the application for an order to show cause, also filed by Plaintiffs, Defendants' response, and Plaintiffs' reply. The Court also considered the brief by Arizona State Senate President Warren Peterson and the response to that brief.

The Court also heard argument on the Defendants ACA's motion to dismiss Plaintiffs' complaint for declaratory and injunctive relief which Defendant ADOR, joined. The Court has also considered the motion, Plaintiffs' response and the ACA's reply, which ADOR also joined. The Court has also considered Plaintiffs' complaint and the Defendants' answers.

There were also declarations filed by the Plaintiffs, as well as a motion by the Free Enterprise Club and Grand Canyon Legal Center to file a brief as *Amicus Curiae*. The Court is granting that motion and considering the *Amicus Curiae* brief included with the motion. The Court also considered all filings on the docket not specified here.

Because the Court is granting Defendants' motions to dismiss, the Court does not address whether Plaintiffs meet the standard for a preliminary injunction.

I. Background Regarding the Program and Plaintiffs' Complaint

In 2022, the Legislature passed HB2156, the Arizona Motion Picture Production Program, now codified as A.R.S. §§ 41–1517, 43–1165. The Program was enacted with a view to creating long-term economic benefits to the state, including the development of employment opportunities for Arizona residents. The Program provides tax credits to film production companies and for film productions based in Arizona.

There are annual limits to the total amount of tax credits available through the program, with the cap ranging from $75 million in 2023 to $125 million in 2025. The tax credits are refundable, so that if a film company's tax liability is less than the credit, the company can receive a refund or a credit voucher to be carried forward and applied against future tax liabilities.

There is a pre-approval process for a company seeking tax credits under the program. And after the movie production is complete, a company must also go through a post-approval process, whereby it submits an audited statement completed by a certified public accountant outlining the eligible production costs. Only after those costs are submitted and considered can the credit be applied and a refund be issued.

The Plaintiffs in this case are two taxpayers, who allege the Program violates the Gift Clause of the Arizona Constitution. The Gift Clause provides in relevant part that the state shall not "ever . . . make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation . . ." Ariz. Const. Art. IX § 7. Plaintiffs claim that the tax credit provided by the Program is an unconstitutional subsidy to the film companies that receive it.

The complaint seeks declaratory relief and asks the Court to find the Program is unconstitutional on its face. Plaintiffs also assert an as-applied challenge to "MoPic-2024-004"—a pre-approved tax credit—and "MoPic-2023-008"—a post-approved tax credit. The Plaintiffs do not specifically allege that the pre-approved tax credit can be claimed against any taxpayer's tax liability. Nor do Plaintiffs claim that either tax credit has resulted or will result in a tax refund for any taxpayer. Rather, the Plaintiffs allege the credits are subsidies because they may result in the state foregoing the collection of income taxes. Plaintiffs also challenge the refundable nature of the tax credits under the Program due to the possibility that companies whose tax credit exceeds their liability will be entitled to a refund. The Plaintiffs further allege the state is not being sufficiently compensated for these subsidies, so they must be struck down under the Gift Clause.

II. Applicable Law

A. Law Governing Motions to Dismiss

The Defendants seek to dismiss this action pursuant to Rule 12(b)(6) of the Arizona Rules of Civil Procedure. In ruling on a Rule 12(b)(6) motion to dismiss, the Court will "assume the truth of the well-pled factual allegations and indulge all reasonable inferences therefrom." *Cullen v. Auto-Owners Ins. Co.,* 218 Ariz. 417, 419 (2008). The Court will grant the motion only if the plaintiff is not entitled to relief "under any facts susceptible of proof in the statement of the claim." *ELM Ret. Ctr., LP v. Callaway,* 226 Ariz. 287, 289 (App. 2010), *quoting Mohave Disposal, Inc. v. City of Kingman,* 186 Ariz. 343, 346 (1996). The Court will not "speculate about hypothetical facts that might entitle the plaintiff to relief." *Cullen, id.* at 420. Nor will the Court "accept as true allegations consisting of conclusions of law, inferences or deductions that are not necessarily implied by well-pleaded facts, unreasonable inferences or unsupported conclusions from such facts, or legal conclusions alleged as facts." *Jeter v. Mayo Clinic Ariz.,* 211 Ariz. 386, 389 (App. 2005).

B. Law Governing Challenges under the Gift Clause

As noted, the Gift Clause of the Arizona Constitution provides that the state shall not "make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation . . ." Ariz. Const. Art. IX § 7. Courts generally use a two-part test to determine if a Gift Clause violation has occurred. The Court first considers whether a challenged expenditure

serves a public purpose, then whether the value to the public is far exceeded by the benefit being provided by the government. *Neptune Swimming Foundation v. City of Scottsdale*, 256 Ariz. 551, 559 (2024). The party alleging a public entity violated the Gift Clause bears the burden of proving it. The Court can also deny a claim of a Gift Clause violation without reaching this analysis if it concludes that no expenditure by the Government has been made. *Kotterman v. Killian*, 193 Ariz. 273, 288 (1999).

III. Analysis

A. Plaintiffs' Claims are Precluded by the Holding in *Kotterman* that Tax Credits Do not Violate the Gift Clause.

The Plaintiffs claim that the Program's tax credits are a subsidy to the film industry prohibited by the Gift Clause. They argue that the tax credits confer a substantial benefit to the film companies with negligible public purpose. Plaintiffs further argue that there is no adequate consideration for the benefit provided because the movies may not ultimately be released and acknowledgement that a movie has been made in Arizona has little value. This Court does not need to decide whether the State receives adequate consideration for the tax credit because under Arizona law tax credits are not subsidies subject to Gift Clause analysis. *Kotterman*, 193 Ariz. at 288. The Arizona Supreme Court in *Kotterman v. Killian* distinguished measures that reduce tax liability, such as tax credits or exemptions, from the type of subsidies prohibited by the Gift Clause. 193 Ariz. at 288.

In *Kotterman*, the Court considered whether tax credits for donations to school tuition organizations violated the Gift Clause. *Id*. The statute at issue in *Kotterman* allowed taxpayers to reduce their tax liability by up to $500 for donations made to school tuition organizations. Before deciding the Gift Clause issue, the Court discussed at length why tax credits—like tax deductions—were not "appropriations" through which the state applied public money to support religious education. *Id*. at 285–87. The Court rejected the notion that taxable income constituted public money before it was even collected. *Id.* at 287 ("It does not follow . . . that reducing a taxpayer's liability is the equivalent of spending a certain sum of money . . . we disagree with [the] characterization of this credit as public money or property within the meaning of the Arizona Constitution"). In addressing the claim that the tax credits violated the Gift Clause, the Court, referencing its prior analysis, denied credits constituted a "gift," because "one cannot make a gift of something that one does not own." *Id*.

Plaintiffs argue that the Supreme Court's recent decision in *Neptune Swimming Foundation*, 256 Ariz. 551, supports their claim that a reduction in tax liability is a benefit under the Gift Clause. In *Neptune Swimming*, the plaintiffs claimed the City of Scottsdale violated the Gift Clause by giving a swim club a below market rate for access to its swim facilities. The Court found that granting a private enterprise exclusive use of city-owned property was tantamount to an expenditure subject to Gift Clause analysis because the state cannot give away public property. *Id*. at 560. Plaintiffs emphasize the Court's finding that foregoing income to be earned on the property was a gift despite the lack of any actual monetary expenditure by the City and argue that *Neptune Swimming* undermined the approach to tax credits in *Kotterman*.

Plaintiffs are mistaken. The Court in *Neptune Swimming* explicitly distinguished *Kotterman*, acknowledging its holding that "the state does not own untaxed taxpayer income," so that "foregoing collecting some of that income by applying the credit could not be a 'gift'." *Neptune Swimming*, 256 Ariz at 560. The *Neptune Swimming* Court contrasted the case before it, emphasizing that the City "own[ed] the property access rights" at issue, and finding it appropriate to apply the Gift Clause to weigh the consideration received for those rights. *Id*. at 560. The Court's holding in *Neptune Swimming* thus does not alter the basic holding in *Kotterman* that tax credits that reduce tax liability are not gifts subject to Gift Clause analysis.

Kotterman's holding that tax credits are not gifts subject to Gift Clause analysis forecloses Plaintiff's claims regarding the Program.

B. The Refundable Nature of the Program's Tax Credits Cannot Save Plaintiffs' Claims.

Plaintiffs attempt to distinguish *Kotterman*, by emphasizing the refundability of the tax credit under the Program at issue in this case, and the potential that film companies would receive a refund if their liabilities don't exceed the credit amount. For the reasons discussed below, however, the possibility that taxpayers will receive a refund does not preclude dismissal of Plaintiffs' claims in this case.

1. *Kotterman* Considered the Possibility Tax Credits Would Result in a Refund.

Plaintiffs argue that despite the general holding in *Kotterman* that tax credits are not gifts barred by the Gift Clause, the tax credits at issue in *Kotterman*, unlike those in this case, were not refundable. The refundable nature of the tax credits issued under the Program means they could result in film companies receiving money directly from state coffers if the credit exceeds their tax liability. Such a refund, they argue, would constitute an expenditure subject to Gift

Clause analysis. The Plaintiffs point to *Palimco, Inc. v. Maricopa County*, 188 Ariz. 550 (1997), where the Court of Appeals applied a Gift Clause analysis to the retroactive reclassification of land that resulted in a tax refund.

The Supreme Court in *Kotterman*, however, which was decided after *Palimco*, also addressed the issue of tax credits being applied in a way that would result in a "profit" for individual taxpayers. The Court held that "[w]hether or not such a maneuver would be possible or allowable is a policy matter for the legislature and the taxing authorities to address rather than this court." *Kotterman*, 193 Ariz. at 287. Although the *Kotterman* Court was not engaging in a Gift Clause analysis when it made this specific finding, its broad holding that tax credits are not gifts—which relies on and incorporates its analysis of whether the tax credits were constitutional—extends to credits that can result in a refund.

2. Even if *Kotterman* Did not Decide the Constitutionality of Refunds under the Gift Clause, Plaintiffs' Claims Still Fail.

a. Plaintiffs Do not Allege Tax Credits under the Program Always Result in a Refund, so their Facial Challenge Must Be Dismissed.

Even if this Court were to find that *Kotterman* did not specifically decide the constitutionality of tax credits thar result in a refund under the Gift Clause, Plaintiffs' facial challenge still fails. A party asserting a facial challenge to the constitutionality of a statute must establish that "no circumstances exist" under which the statute's application would be constitutional. *State v. Burke*, 238 Ariz. 322, 325 (App. 2015). In this case, *Kotterman* conclusively established that tax credits that reduce tax liability do not violate the Gift Clause. Plaintiffs do not claim that the credits offered through the Program will always result in a refund, so their facial challenge must fail.

b. Plaintiffs Do Not Allege either of the Challenged Film Credits Would Result in a Refund, so both As Applied Challenges Must also Fail.

Plaintiffs' as applied challenges to MoPic-2023-008 and MoPic-2024-004 must also fail even if *Kotterman* left open the question of the constitutionality of refundable tax credit under the Gift Clause. The Plaintiffs do not allege that the challenged tax credits will result in a refund for either of the taxpayers who will receive them. The tax credit that has only been pre-approved, may not ever reach the post-approval stage. The tax liabilities of the taxpayers with

the challenged credits may exceed the credit amount.[1] For that reason, the Defendants also sought dismissal pursuant to Rule 12(b)(1) for lack of jurisdiction:

> [I]t is well settled that a declaratory judgment must be based on an actual controversy which must be real and not theoretical. To vest the court with jurisdiction to render a judgment in a declaratory judgment action, the complaint must set forth sufficient facts to establish that there is a justiciable controversy. A 'justiciable controversy' arises where adverse claims are asserted upon present existing facts, which have ripened for judicial determination.

Planned Parenthood of Tucson v. Marks, 17 Ariz.App. 308, 310 (App. 1977) (internal citations omitted); see also *Cullen, id.* at 420 (the Court will not "speculate about hypothetical facts that might entitle the plaintiff to relief"). The failure to allege either MoPic-2023-008 or MoPic-2024-004 will actually result in a refund bars Plaintiffs from pointing to refundability as the reason their challenge to these specific tax credits survive *Kotterman*.

For the reasons stated above,

IT IS ORDERED dismissing the Plaintiffs' complaint.

IT IS FURTHER ORDERED denying the motion for a preliminary injunction as moot.

[1] Defendants also point out that any credit surplus could also be applied to the next year's tax liability and it is also unknown whether this would occur.