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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN AND FOR THE COUNTY OF MARICOPA

DEBORAH McEWEN; JAN MITTELSTAEDT, Plaintiffs, vs. BOARD OF DIRECTORS OF THE ARIZONA COMMERCE AUTHORITY, an agency of the State of Arizona; et al., Defendants.	Case No. CV2025-001929 **PLAINTIFFS' RESPONSE TO MOTION TO DISMISS** (Assigned to The Honorable Michael Herrod)

INTRODUCTION

This lawsuit challenges the constitutionality of the Arizona Motion Picture Production Program ("Program")—a government subsidy to private filmmaking companies designed to encourage them to make movies in Arizona. The Legislature fashioned this "incentive" as a refundable tax credit, meaning that companies making movies in Arizona can qualify not only to have their tax liabilities reduced, but to receive a check for whatever is left over after their liabilities have been zeroed out.[1]

[1] A refundable tax credit means that the taxpayer receives a payment, issued by the state, even when the taxpayer has *no* tax liability to offset, or in excess of any taxes which the recipient previously paid. Joseph Link, *Adopting Tax Credits: The Federal Government's Special Need to Adopt Missouri's Adoption Tax Credit*, 8 Bus. Entrepreneurship & Tax L. Rev. 260, 263 (2024); *Refundable Tax Credit*, West's Tax Law Dictionary § R880. In other words, the "incentive" payment is really an *appropriation* of funds collected from *other* taxpayers, including Plaintiffs (who themselves will never receive a refund of the subsidy).

Plaintiffs ("Taxpayers") contend that this violates the Arizona Constitution's Gift Clause. That Clause (Ariz. Const. art. IX § 7) prohibits the allocation of public resources to private parties that deplete the public treasury or the conferring of special advantages on private, special interests. *See, e.g., Turken v. Gordon*, 223 Ariz. 342, 348 ¶¶ 21–22 (2010). The payments provided under the Program do both of those things.

Although labelled as "tax credits," the payments provided under the Program are *not* just credits that merely offset a recipient's tax liability. Instead, they function as direct subsidies. Here's how refundable tax credits work:

> If a taxpayer owes the government $5,000 at the end of the year, a $1,000 tax credit will reduce the taxpayer's liability to $4,000. … A refundable credit [by contrast,] is a tax credit that is able to be refunded if a taxpayer's credit exceeds the liability. For example, if a taxpayer owes the government $500 at the end of the year, a $1,000 tax credit will not only reduce the taxpayer's liability to $0, but it will also result in a $500 payment to the taxpayer.

Link, *supra,* at 263. So, when the amount awarded under the Program exceeds the amount of taxes the beneficiary owes, Arizona writes a check to the beneficiary for the difference.

In brief, the Legislature has appropriated $125 million per year to fund private film production in the state, which accomplishes no public purpose and acquires no direct consideration in return. That violates the Gift Clause.

Defendant Arizona Commerce Authority ("ACA"), joined by Defendant Arizona Department of Revenue ("ADOR") moves to dismiss under Rules 12(b)(6) and 12(b)(1). Their arguments fail.

First, the Gift Clause bans *any* form of government aid to private entities—whether it's money, tax exemptions, or exclusive privileges—by using sweeping and unambiguous language like "donation or grant, *by subsidy or otherwise*."

Courts have consistently and strictly applied this Clause for over a century, striking down even indirect or non-monetary benefits as unconstitutional subsidies, and reaffirming that *all* government aid to private parties is subject to Gift Clause scrutiny. *See, e.g., Neptune Swimming Found. v. City of Scottsdale*, 256 Ariz. 551 (2024) (low-cost

use of government owned resources); *City of Tempe v. Pilot Props., Inc.*, 22 Ariz. App. 356 (1974) (below-market lease to private party); *Pimalco, Inc., v. Maricopa Cnty.*, 188 Ariz. 550 (App. 1997) (elimination of tax liability); *Maricopa County v. State*, 187 Ariz. 275 (App. 1996) (elimination of tax liability).

The refundable tax credits challenged here eliminate liabilities and give outright payments to private parties to subsidize private enterprise. That violates the plain text of the Gift Clause, its core purposes, and a long line of cases interpreting it.

Second, Defendants' reliance on *Kotterman v. Killian,* 193 Ariz. 273 (1999), is misplaced. That case involved a charitable tax credit where taxpayers merely chose how to direct their payments. No public funds ever changed hands—and no private party received a public benefit. Thus the Gift Clause was not violated. In contrast, this Program provides tax credits and even direct *payments out of the state treasury* to select private beneficiaries. That makes it a clear subsidy, and exactly the type of public-to-private transfer the Gift Clause was designed to prohibit.

Third, Defendants' separation-of-powers argument would expand the scope of the Legislature's taxing authority beyond the reach of judicial review. But the separation of powers (Ariz. Const. art. III) contemplates—indeed requires—judicial review of unconstitutional legislative acts, including in the realm of taxation. *See, e.g., Turken*, 223 Ariz. at 346 ¶ 14 (determining whether a government expenditure serves a public purpose "is ultimately the province of the judiciary."); *Gilmore v. Gallego*, 552 P.3d 1084, 1092 ¶ 34 (Ariz. 2024) (judicial review applies "in all Gift Clause cases.")

Fourth, Defendants' claim that applying the Gift Clause to tax credits would destabilize Arizona's tax system is exaggerated and unfounded. Mot. at 2. This case concerns not the ordinary types of tax credits or refunds that are both commonplace and constitutionally sound. It concerns *targeted subsidies*—refundable credits for film production that take the form of eliminating actual liabilities and even the direct payments of public funds. Declaring such subsidies unconstitutional won't "upend" anything, it will

simply implement the Constitution's clear ban on using public funds to underwrite private businesses.

Finally, Defendants' argument against taxpayer standing is squarely foreclosed by a long line of cases establishing broad standing for taxpayers who sue to enjoin the unlawful expenditure of taxpayer funds—especially *Ethington v. Wright*, 66 Ariz. 382 (1948), which firmly established that taxpayers have standing to challenge illegal public expenditures, like the $125 million in refundable tax credits at issue here. As taxpayers, Plaintiffs are responsible for providing the funds appropriated to private filmmakers. Consequently, each has standing to challenge the constitutionality of taxpayer-funded expenditures. Even if no funds have been disbursed yet, Arizona law allows challenges to threatened or likely unconstitutional spending.

The motion to dismiss should be denied.

BACKGROUND

The Program is the latest in a series of failed experiments to "spur economic activity" by subsidizing the state's film industry. Mot. at 1; *see also* Compl. ¶¶ 29–52. It was enacted amid intense budget negotiations in a year when the Legislature was searching for ways to appropriate surplus tax dollars. *See id.* ¶¶ 54–58. The Legislature knew the Program would result in a "loss of General Fund revenue" up to $125 million per year. *Id.* ¶¶ 60, 76.

The Program is administered by the ACA and ADOR. *See, e.g., id.* ¶¶ 62, 70, 77–78, 81–82, 97. The ACA handles pre- and post-approval for eligibility, and ADOR ultimately processes credits along with the production company's tax return, and issues payments to beneficiaries. *Id.* ¶¶ 70, 81–82.

Film companies must meet certain statutory qualifications to claim refundable tax credits, such as filming and/or producing a project in the state and acknowledging this in the film's credits. But recipients are not required to actually release or distribute any subsidized film to receive the credit or payment. *Id.* ¶¶ 64–68, 102–04, 110.

Plaintiffs are two Arizona income taxpayers whose tax dollars pay for the Program subsidies and who have a legal obligation to replenish the public coffers for unlawful disbursements. *Id.* ¶¶ 1, 3–4, 146. They allege that the Program's authorizing statutes facially violate the Gift Clause, and that two specific credits (one pre- and one post-approved by the ACA) violate the Gift Clause as applied. *Id.* ¶¶ 125–58.

LEGAL STANDARD

Rule 12(b)(6) motions to dismiss are disfavored. *Luchanski v. Congrove*, 193 Ariz. 176, 179 ¶ 17 (App. 1998). They may be granted "*only* if 'as a matter of law [] plaintiffs would not be entitled to relief under *any* interpretation of the facts susceptible of proof.'" *Coleman v. City of Mesa*, 230 Ariz. 352, 356 ¶ 8 (2012) (citation omitted; emphasis added). "In determining if a complaint states a claim on which relief can be granted, courts *must* assume the truth of all well-pleaded factual allegations and indulge *all* reasonable inferences from those facts." *Id.* at ¶ 9 (emphasis added).

Plaintiffs' Complaint easily satisfies Arizona's pleading standard.

ARGUMENT

I. The Arizona Motion Picture Production Program and its taxpayer-funded payments to private parties are subject to Gift Clause scrutiny.

A. The text of the Gift Clause and controlling precedent show that the Clause applies to subsidies of all kinds, including "refundable tax credit" payments.

The Gift Clause unequivocally prohibits government subsidies to private entities. It provides 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. This sweeping language—"the strongest prohibition ever devised against government subsidies to private businesses," Sandefur, *The Origins of the Arizona Gift Clause*, 36 Regent U. L. Rev. 1, 55 (2024)—leaves no doubt that the Clause applies to *all* forms of public aid, regardless of how they are labeled or structured.

The Clause's text is unambiguous. A "donation" is "[t]he act of giving something, esp. money, to help a person or an organization." *Donation*, Black's Law Dictionary (12th

ed. 2024). A "subsidy" is "[a] grant, usu[ally] made by the government, to any enterprise whose promotion is considered to be in the public interest … [s]ubsidies are usu[ally] indirect. They may take the form of … *tax breaks*." *Subsidy*, *id.* (emphasis added).[2] The phrase "by subsidy *or otherwise*" comprehensively forbids government aid to private enterprise, under any pretext or in any form.

That's why for over a century, courts have applied the Clause to declare all forms of subsidies—whether direct cash payments or not—unconstitutional. The Clause has been applied to debt forgiveness, below-market leases, and in-kind aid. *See, e.g., Rowlands v. State Loan Bd.*, 24 Ariz. 116, 123 (1922) (eliminating debt was an unconstitutional subsidy); *Puterbaugh v. Gila Cnty.,* 45 Ariz. 557, 564 (1935) (elimination of debt was "clearly a donation" in violation of the Gift Clause); *Pilot Props.,* 22 Ariz. App. at 362 (below-market-rate leases of government property violates the Gift Clause). Certain kinds of taxation-based subsidies can also be unconstitutional gifts. In *Maricopa Cnty., supra*, and *Pimalco, Inc., supra*, courts analyzed whether certain tax exemptions qualified as gifts. (Although those exemptions passed muster, they differed in crucial ways from the payments at issue here.) *See also Englehorn v. Stanton*, No. CV2017-001742, 2020 WL 7487658 (Ariz. Super. Ct., June 19, 2020) (finding certain tax subsidies unconstitutional).

In short, whenever the government gives *anything* of value to a private entity for non-public reasons, or when it fails to receive in return something of comparable value, it is engaged in subsidizing—which violates the Gift Clause.

Defendants are therefore wrong to argue that a tax credit cannot violate the Gift Clause because it "is not a 'conveyance' or 'grant of money.'" Mot. at 6. The courts have been clear that the Gift Clause is violated by government subsidies even if those subsidies aren't a "conveyance" or "grant." Last year, in *Neptune Swimming Foundation*, *supra*, the

[2] The second edition of *Black's*, published the same year Arizona's Constitution was written, defined "subsidy" as financial aid given to "any enterprise, work, or improvement in which the government desires to participate, or which is considered a proper subject for state aid, because likely to be of benefit to the public." *Subsidy*, Black's Law Dictionary 1117 (2d ed. 1910).

Supreme Court rejected that argument when offered by the City of Scottsdale. There, the city allowed a private swim club to use city-owned swimming pools, charging it below-market rates. Like Defendants, Scottsdale argued that the Gift Clause did not apply because the license "[did] not cost the City anything" and did not involve the government "spend[ing] money." 256 Ariz. at 560 ¶ 27. But the court held that that "even absent a monetary cost to the City," granting special advantages, *including "foregoing collecting" money*, triggers Gift Clause scrutiny. *Id.* at ¶¶ 28, 29 (emphasis added). *Cf. Pilot Props.*, 22 Ariz. App. at 360–63 (leasing government-owned land at below-market rates was a subsidy because it benefited the recipient in the amount of the difference between the market rate and the charged rate).

Arizona courts have unwaveringly held that exempting someone from financial liabilities she would otherwise have to pay can be an unconstitutional subsidy. In *Rowlands*, 24 Ariz. at 123, the Supreme Court found it unconstitutional for the state to forgive interest due on certain loans, because this was "a donation, a pure and simple gratuity." In *Puterbaugh*, 45 Ariz. at 564, the court found that it violated the Gift Clause for the legislature to forgive a person's debt to the state. Thus Arizona law is clear: contrary to Defendants' contention (Mot. at 6), the Gift Clause applies to *all* forms of subsidies[3] regardless of whether they involve a direct "grant of money."

Yet, as noted above, the Program here does *not* merely forego potential state revenues. It goes further, and makes *actual payments out of funds held by the state*. Defendants' effort to characterize the Program as a mere tax exemption ignores reality. Under this Program, the government grants select private companies substantial *refundable* tax credits for engaging in those companies' ordinary business activities (making films) and, if the company's tax liability is less than the credit, the State literally provides a direct payment to the company. Because the Program involves the actual

[3] Indeed, the ACA itself has previously described earlier versions of the "film tax credit"—which were far more limited than the current scheme—as *subsidies*. *See* Compl. Ex. 3 at 9 ("Based on the total tax incentives post-approved … the State *subsidized* (paid for) 13.7% of the spending in Arizona" (emphasis added)).

payment of money to private recipients in order to subsidize activities, it is subject to Gift Clause scrutiny. *Duke v. Yavapai Cnty*., 24 Ariz. 567, 573 (1923).

B. Plaintiffs have adequately pleaded a claim under the Gift Clause.

The Gift Clause requires that any expenditure, or other giving of value, by the state to a private entity must (a) accomplish a public purpose, and (b) obtain "consideration" that is proportional in value to the benefit the private entity receives. In other words, the government can spend money (or give other benefits) but only for public goals and only to acquire things that are of proportionate value. *Schires v. Carlat,* 250 Ariz. 371, 374 ¶ 7 (2021).

If allowed to prove up their allegations, Taxpayers will show that the Program accomplishes neither of these requirements. It serves no public purpose because it is simply intended "to aid in a private enterprise." *City of Tombstone v. Macia*, 30 Ariz. 218, 223 (1926). Arizonans obtain no specific public good from the fact that films are made (but not even necessarily released) in Arizona. Nor does the Program acquire any proportionate consideration, because the value of a "filmed in Arizona" tag in the end-credits of a movie are simply not worth the substantial subsidies the Program provides. The Program's purported economic benefits are, if anything, "anticipated" and "indirect" (such as general economic development) which are irrelevant in the Gift Clause's consideration analysis. *Schires*, 250 Ariz. at 376 ¶ 14.

The Gift Clause exists: (1) to prevent "the 'depletion of the public treasury or inflation of public debt by [public entities] engag[ing] in non-public enterprise,'" *Town of Gila Bend v. Walled Lake Door Co.*, 107 Ariz. 545, 549 (1971) (citation omitted); and (2) to prevent government from "giving advantages to special interests." *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984). The subsidy at issue here does both.

It is axiomatic that decreasing someone's liabilities is equivalent to increasing her assets. *See, e.g., United States v. Kirby Lumber Co.,* 284 U.S. 1, 2–3 (1931). That's why *Rowlands*, 24 Ariz. at 123, and *Puterbaugh*, 45 Ariz. at 564, said that laws that eliminate people's financial obligations to the state are unconstitutional gifts. It's also why courts

apply Gift Clause analysis to laws that eliminate tax liabilities. *See, e.g., Pimalco, Inc.*, 188 Ariz. at 560; *Maricopa Cnty*, 187 Ariz. at 279–81.

Subsidizing the movie industry is exactly the type of action the Gift Clause's framers sought to prohibit. As the Supreme Court explained in *Industrial Development Authority v. Nelson*, 109 Ariz. 368 (1973), the Clause was adopted to avoid the economic calamities of the nineteenth century, when municipal governments gave "money, credit or *other valuable advantages*" to favored private enterprises like railroads and canal companies. *Id.* at 372 (emphasis added). Indeed, tax-exemption subsidies were a commonplace form of subsidy in the years before the Constitution was written. After years of boondoggle projects during the territorial era—especially subsidized railroads—Arizonans adopted a constitution that forbids tax-exemption or tax-refund subsidies just like other kinds of subsidy. They did so by including the comprehensive language "by subsidy *or otherwise*" to the Gift Clause. *See* Sandefur, *supra,* at 48–55.[4]

The subsidy Program for movies raises the same constitutional concerns as subsidies for railroads did. It eliminates tax liabilities for—and, in many cases, directly gives taxpayer funds—to a narrow class of private beneficiaries. Selectively eliminating tax liability for, and even writing checks to, one private interest in order to subsidize its business will deplete the public treasury or inflate the public debt.

The Program is not a general incentive available to all; it's a targeted subsidy for a chosen few. And it's precisely the kind of special benefit that results in the depletion of public funds that the Clause was enacted to prevent. The Program is, therefore, subject to—and fails—Gift Clause scrutiny.[5]

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[4] The first draft of the Clause would have applied solely to appropriations of public money. Goff, ed., *Records of the Arizona Constitutional Convention* 1266 (1991). The framers rejected that draft, in part out of a concern that it would allow tax exemptions for railroads. Sandefur, *supra,* at 54. Instead, they adopted the comprehensive language that prohibits aid to private businesses "by subsidy or otherwise." Moreover, the 1891 proposed constitution, which was never adopted, expressly allowed for tax exemption subsidies, *id.* at 49-51, and the 1910 framers chose *not* to follow that model. *Id.* at 52-53.

[5] Contrary to Defendants' argument (Mot. at 4), no presumption of constitutionality can save the Program. Regardless, any presumption of constitutionality should be discarded. *State v. Arevalo*, 249 Ariz. 370, 378–82 ¶¶ 29–46 (2020) (Bolick, J. concurring).

C. *Kotterman* is distinguishable.

Defendants rely on *Kotterman* to argue that the refundable tax credits are not subject to Gift Clause scrutiny because "the state had nothing to give away." Mot. at 6. That argument fails, however, because *Kotterman* concerned a *non*-refundable tax credit—a very different creature from the refundable tax credits at issue here. The program in *Kotterman* allowed Arizona taxpayers to donate up to $500 to a charitable school tuition organization and then claim that donation as a credit against their state income tax liability. 193 Ariz. at 276 ¶ 1. Under that program, taxpayers *still had to pay*—their financial liability was not lessened—and they did *not* receive money from any other taxpayer. Instead, the law merely gave them a choice of *whom* to pay: either the state or a qualifying charitable entity. Either way, their financial position remained unchanged. That's why the Court concluded there was no "donation or grant, by subsidy or otherwise" in that case. *Id.* at 288 ¶ 51.

The opposite is true here. Under the Program, the State reduces the tax liability of film companies—and in many cases, gives them cash—if they make movies in Arizona. The Program therefore reduces their liabilities or increases their assets, which was not true in *Kotterman.* There, taxpayers simply chose *who* got their money. Here, the recipients either *don't have to pay,* or *actually get a check from the state,* when they engage in the kind of business the state wants to subsidize.

As for Defendants' claim that the Gift Clause does not apply because "the state cannot own taxable income that taxpayers have not yet earned," Mot. at 5, that argument is foreclosed by *Neptune Swimming Found.*. There, the court held that the government's transfer of valuable use-rights to a private party triggers Gift Clause scrutiny "even absent a monetary cost to the City." 256 Ariz. at 560 ¶ 28. The dispositive issue is not whether money has changed hands—although that is also happening here—but whether the government is conferring a special benefit on a private party out of public resources to subsidize it. *See also Pilot Props*., 22 Ariz. App. at 360–63. That's exactly what the Program does.

D. The refundable tax payments under the Program are a grant of public money.

The Defendants contend that "[a]n income tax credit is not a … 'grant of money.'" Mot. at 6. But the refundable payments authorized by the Program are, by definition, a grant of public funds. The applicable statutes (A.R.S. §§ 43-1082 and 43-1165), provide that the State issues *refundable* tax credits under the Program. A refundable credit is not just a reduction in tax liability, but a mechanism by which the State *cuts a check* to the taxpayer if the credit exceeds what the taxpayer owes. *See* Comp. Ex. 8 ("The bill would authorize ACA to pre-approve up to $150 million in *refundable* credits per calendar year. (Unlike a non-refundable credit, a refundable credit is not limited by the taxpayer's liability.")).

Under Section 42-1118, if a film company's credit exceeds its liability, the State must either: (1) "[R]efund the entire amount of tax, interest and penalty, in a lump sum or in not more than five annual installments"; or (2) "[I]ssue to the taxpayer a credit voucher … to be carried forward and applied against future tax liabilities." In other words, the Program actually directs cash payments to companies that qualify for credits that exceed their tax liability.

Take the following example. The ACA has approved a $1,220,624 credit for entity MoPic-2024-004 for the 2024 tax year. *See* Compl. ¶ 158. If that company has a tax liability of only $500,000,[6] the statute requires the State to issue a cash "refund"—or equivalent voucher—for the difference: $720,624. That *is* public money going directly from the State treasury to a private company.

The Defendants attempt to recast this as merely a case of the "taxing entity forg[oing] revenues that it could have chosen to collect in the future," Mot. at 6, but that's simply not true. These are not hypothetical future revenues the State has declined to pursue. It is not the state taxing at a low rate instead of a high rate. Rather, these are

[6] At this stage of the litigation, we don't know the actual tax liability of the production company in charge of MoPic-2024-004 (or even the recipient's identity). This example is offered for illustrative purposes—and demonstrates why this case should proceed to discovery.

current, *appropriated* cash outlays to private businesses that can exceed a film company's tax obligations. The Program does not merely "reduce taxes." It gives taxpayer dollars to qualifying recipients. That's a public expenditure—and triggers the Gift Clause.

To be sure, even *non-refundable* tax credits that confer special advantages on private entities are subject to Gift Clause scrutiny. *Cf. Maricopa Cnty., supra; Pimalco, supra*. But *refundable* tax credits—particularly when they result in affirmative cash payments—are plainly grants of public money subject to the Gift Clause's limitations.

II. The Legislature's taxing and policymaking powers are subject to constitutional limitations—including the Gift Clause—and therefore to judicial review.

The ACA makes the extraordinary claim that "[t]he enactment of tax credits falls squarely within the Legislature's discretion," and that such questions should not "burden the judicial branch." Mot. at 9. Defendants argue that judicial scrutiny of tax credits for constitutional defects would somehow conflict with the separation of powers. *Id.* at 7. That argument is contrary to a century of Arizona precedent.

The Legislature's "discretion" does not include the power to "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. IX § 7, and courts have always applied meaningful scrutiny to taxing and spending actions by the government to ensure that they comply with this constitutional rule.[7] They have, moreover, made clear that the question of whether a form of aid to a private entity violates the Gift Clause "is ultimately the province of the judiciary." *Turken*, 223 Ariz. at 346 ¶ 14.

Nor are legislative decisions respecting taxes exempt from judicial review. Courts routinely adjudicate the constitutionality of tax laws (*see, e.g., Fann v. State*, 251 Ariz. 425 (2021)), and tax exemptions (*Maricopa Cnty., supra; Pimalco, supra*), and tax credits (*Kotterman, supra*), and, of course, expenditures (*Turken, supra*; *Gilmore, supra*).

[7] Even before statehood, in *McRae v. Cnty. of Cochise*, 5 Ariz. 26, 32–33 (Ariz. 1896), the territorial supreme court declared it unconstitutional for the state to pay $3,000 to people who dug wells, because that was a subsidy.

It's true that the Legislature enjoys the constitutional power to tax. Ariz. Const. art. IX § 1. But that power is subject to a variety of constitutional limitations,[8] including the Gift Clause, and enforcing constitutional limits is not judicial policymaking—it's ordinary judicial review. As the Supreme Court said in *Forty-Seventh Legislature v. Napolitano*, 213 Ariz. 482, 485 ¶ 8 (2006), it is "traditionally" the courts' job "[t]o determine whether a branch of state government has exceeded the powers granted by the Arizona Constitution … . Although each branch of government must apply and uphold the constitution, our courts bear ultimate responsibility for interpreting its provisions."

Bizarrely, the Motion argues that the Gift Clause is "consistent with Arizona's territorial practice of providing certain private entities tax exemptions." Mot. at 9. But the Gift Clause was adopted to *halt* such practices. *See* Sandefur, *supra* at 43–56. The purported examples the ACA cites are revealing. Quoting legal historian John Leshy, it says that "[t]he Territorial Legislature granted tax exemptions to new railroads in 1897, 1899, 1901, and 1903." Mot. at 9 (quoting Leshy, *The Making of the Arizona Constitution*, 20 Ariz. St. L.J. 1, 12 n.58 (1988)). But those were all *before the Gift Clause was adopted*, which was in 1912, and therefore cannot prove that tax-exemption subsidies are constitutional under that Clause.[9]

What's more, Leshy cites these examples to prove that "[c]oncern about giant corporations evading taxation had been repeatedly rehearsed in the territorial legislature to little avail, demonstrating the railroad and mining companies' strong grip on the political process." *Supra* at 11–12. It was precisely to *end* those abuses that the Gift Clause was created. *See* Sandefur, *supra* at 56 ("Arizona's Gift Clause reflects an effort to address … persistent concerns with government interaction

[8] Even one of the cases Defendants rely on acknowledges this obvious principle. *See* Mot. at 8 (quoting *Tanque Verde Enters. v. City of Tucon*, 142 Ariz. 536, 542 (1984) (the Legislature may set the rate of a "*legally imposed*" tax (emphasis added))).

[9] To cite the subsidies of 1903 as proof that they're constitutional under the 1912 Gift Clause is like arguing that the censorship imposed by Parliament in the seventeenth century is constitutional under the First Amendment.

[with] private enterprise … . It also reflects … two waves of reform that first restricted state aid to private businesses and then later limited local subsidies.").

III. Arizona's broader tax framework will survive without unconstitutional subsidies.

Defendants melodramatically claim that analyzing tax credits under the Gift Clause would "upend Arizona's tax framework." Mot. at 9. That's not true.

While tax credits, deductions, exemptions, and classifications are subject to constitutional scrutiny, not all such policies violate the Gift Clause. For example, the Clause imposes no limitation on the government's capacity to reduce taxes across the board, or to provide payments to private parties for public purposes, as long as it receives proportionate value in return. *See, e.g., Pimalco, Inc*., 188 Ariz. at 560–61. Gift Clause concerns only arise when tax incentives operate as subsidies—giving public resources or special benefits to private entities without serving a public purpose or acquiring adequate return. *Schires*, 250 Ariz. at 374-75 ¶ 7.

This Court need not wade into complex policy questions about tax relief or public welfare initiatives, as Defendants invite the Court to do, to find a violation here. Mot. at 11. The only tax credit at issue is the refundable tax credit provided by this Program. Under that Program, beneficiaries receive "money, credit or *other valuable advantages,*" *Nelson*, 109 Ariz. at 372, without achieving a public purpose, and without providing proportionate consideration in return. Declaring that subsidy unconstitutional won't unravel Arizona's tax code. It will simply reaffirm that the state cannot use the tax system to funnel public funds to private enterprises.

IV. Plaintiffs have taxpayer standing to challenge unconstitutional subsidies.

Finally, Defendants' standing argument is foreclosed by the very cases cited in the Motion to Dismiss, along with other precedent that confers broad standing on taxpayers who challenge unlawful expenditures.

Most notably, *Ethington, supra,* squarely contradicts Defendants' view of taxpayer standing. As their Motion acknowledges, *Ethington* was grounded in the principle that

"taxpayers[] [have an] equitable ownership of [public] funds and … [are] liab[le] to replenish the public treasury for the deficiency which would be caused by [a] misappropriation." Mot. at 13 (quoting *Ethington*, 66 Ariz. at 386). That equitable ownership gives them standing to challenge illegal expenditures in court.

Defendants try to sidestep this by claiming such standing only exists to challenge "misappropriation" of funds, and that this case does not involve misappropriation because (they claim) *Kotterman* held that tax credits aren't "appropriations." *Id.* (citing *Kotterman*, 193 Ariz. at 288 ¶ 50). That's wrong. *Kotterman* involved a *nonrefundable* tax credit, which is categorically different from the *refundable* tax credit at issue here. A *refundable* tax credit certainly is an appropriation.

Also, taxpayer standing is not limited to expenditures. It arises from the taxpayer's "equitable interest" in public funds which the taxpayer would be forced to replenish if misused. *Rodgers v. Huckelberry*, 247 Ariz. 426, 429 ¶ 12 (App. 2019).[10] That's why taxpayers have standing to challenge not just expenditures but also other "pecuniary loss[es] attributable to [a] challenged transaction." *Dail v. City of Phoenix*, 128 Ariz. 199, 202 (App. 1980). Notably, the parties in *Kotterman* itself were taxpayers, and nobody doubted their standing to challenge the tax credits at issue.

Defendants claim that *Welch v. Cochise Cnty. Bd. of Supervisors*, 251 Ariz. 519 (2021), shows that the Program's effect on Taxpayers is "too remote" to qualify as an injury. Mot. at 13 (quoting *Welch,* 251 Ariz. at 525 ¶ 19). But *Welch* was different, because there, the money had already been appropriated, and the taxpayer was simply arguing over who should get it. The plaintiff challenged the county's choice to hire Mr. Call for a job that already existed and was already funded: "The Board appointed Call to a preexisting position, which was paid a preexisting salary, which was funded by a preexisting tax levy." *Welch*, 251 Ariz. at 525 ¶ 19. As a result, a ruling in the plaintiff's

[10] For this reason, Defendants' discussion of the possibility *vel non* of "refunds" is irrelevant. Mot. at 14. Taxpayer standing does not depend on the possibility of "refunds." It turns on whether the government uses public resources in such a way that the taxpayer is "liab[le] to replenish the public treasury for the deficiency." *Ethington,* 66 Ariz. at 386.

favor "would not redress [his] injury" or "keep those already-appropriated funds from being used to pay the seat's eventual occupant." *Id.* ¶ 20. The plaintiff therefore lacked taxpayer standing.

But here, there are no "preexisting" recipients. The statute governing the Program allocates $125 million annually to the credits. A.R.S. § 41-1517(I)(3). Beneficiaries will receive checks that otherwise would not have been sent—so this does not involve a "preexisting" expenditure or "preexisting levy," as *Welch* did. Instead, the longer the Program operates, the more money will be sent to beneficiaries, or the more beneficiaries' tax liabilities will be excused—and the more these Taxpayers will be "liab[le] to replenish the public treasury for the deficiency." *Ethington*, 66 Ariz. at 356. Therefore, the Taxpayers have standing.

Dail, supra, also does not support Defendants' position. The question there was whether the taxpayer had standing to challenge expenditures of funds that were raised *not* by taxation but by fees paid by water users. *See* 128 Ariz. at 202 ("the expenditures have always been made from revenue generated by the operation of the water system, not from funds raised by taxation."). Here, by contrast, it is undeniable that the payments the Program beneficiaries will receive—or the elimination of liabilities they will enjoy—is ascribable to tax moneys, not to revenues obtained through user fees or other sources. *Dail* is therefore irrelevant.

Defendants also claim that taxpayers lack standing because the final amount of expenditures is not yet known. Mot. at 14. But Taxpayer standing does not require the actual disbursement of public funds prior to taxpayers' ability to bring suit. Instead, the *threat* of an unlawful expenditure is enough to confer standing. *Secrist v. Diedrich*, 6 Ariz. App. 102, 104 (1967) ("taxpayer has sufficient standing to question in an appropriate action illegal expenditures made *or threatened* by a public agency." (emphasis added)); *accord, Smith v. Graham Cnty. Cmty. Coll. Dist.*, 123 Ariz. 431, 433 (App. 1979).

Finally, even if Taxpayers' standing were in doubt, standing is a prudential doctrine in Arizona, not a jurisdictional or constitutional barrier. *See, e.g., Dobson v. State*

ex rel. Comm'n on App. Ct. Appointments, 233 Ariz. 119, 122 ¶ 9 (2013). Courts routinely consider cases where prudential concerns weigh in favor of review, particularly when important constitutional questions of statewide importance are at stake, and that is true of the Program.

CONCLUSION

The Court should deny the motion.

RESPECTFULLY SUBMITTED this 9th day of June 2025.

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