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IN THE SUPERIOR COURT FOR THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

DEBORAH McEWEN, *et al.*,

Plaintiffs,

v.

BOARD OF DIRECTORS OF THE ARIZONA COMMERCE AUTHORITY, *et al.*,

Defendants.

Case No. CV2025-001929

BRIEF OF ARIZONA STATE SENATE PRESIDENT WARREN PETERSEN AS *AMICUS CURIAE*

(Filed Pursuant to A.R.S. § 12-1841)

(Assigned to The Hon. Michael Herrod)

Pursuant to A.R.S. § 12-1841, Warren Petersen, in his official capacity as the President of the Arizona State Senate, respectfully submits this brief as *amicus curiae* in support of the Plaintiffs. The refundable tax credits—*i.e.*, payments of taxpayer funds—created by the Arizona Motion Picture Production Program, *see* A.R.S. §§ 41-1517, 43-1082, 43-1165 (the "Program"), are a subsidy to private companies, and accordingly contravene Article IX, Section 7 of the Arizona Constitution (the "Gift Clause").

INTRODUCTION

President Petersen concurs with the arguments set forth in the Plaintiffs' response to the motion to dismiss, but writes to underscore two specific points.

First, far from derogating the separation of powers, the Court's invalidation of the Program would vindicate it. While President Petersen appreciates the Defendants' purported solicitude for judicial restraint, the Gift Clause embodies a limitation on the elected branches; it subordinates transient political impulses to a transcendent respect for the sanctity of property rights, and the principle that public resources cannot be deployed for private gain.

Second, the Defendants conflate tax exemptions and tax subsidies, amalgamating all "credits, deductions, and exemptions" into a unitary concept of "tax policy," which they argue is an exclusively "legislative function." Mot. at 2, 8. But this formulation elides critical economic and constitutional distinctions. When the government merely refrains—by extending an exemption, deduction, or offset—from taxing any or some portion a citizen's private property, the Gift Clause generally is not implicated. A refundable tax credit, by contrast, does not merely leave private property with its owner; it affirmatively transfers public funds to businesses that already have had their tax liability extinguished. Cloaking a handout of public resources in the rhetorical veneer of 'tax relief' does not and cannot alter its intrinsic character as a subsidy. The Defendants' professed anxiety at judicial oversight of these expenditures obscures that more insidious dangers lie in allowing semantic sleights to defeat constitutional guarantees.

INTEREST OF THE *AMICUS CURIAE*

Warren Petersen is the President of the Arizona State Senate. The complaint challenges the constitutionality a state statute, *see* 2022 Ariz. Laws ch. 387, and Arizona law provides that the President of the Senate is "entitled to be heard" and "may file briefs" "[i]n any proceeding in which a state statute . . . is alleged to be unconstitutional." A.R.S. § 12-1841(A), (D).

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ARGUMENT

I. Rigorous Enforcement of the Gift Clause Comports With the Separation of Powers

"In Arizona, the legislature is endowed with the legislative power of the State, and has plenary power to consider any subject within the scope of government unless the provisions of the Constitution restrain it." *State ex rel. Napolitano v. Brown*, 194 Ariz. 340, 342 ¶ 5 (1999). Embedded in this statement are the two cardinal axioms of republican government. As the branch bearing a direct representative nexus to the people, the Legislature "may in the exercise of the sovereign powers of the state, enact any law its discretion may dictate." *Roberts v. Spray*, 71 Ariz. 60, 69 (1950). But even that expansive authority is modulated by the Constitution's structural constraints on the elected branches. If a legislative enactment veers outside one of these guardrails, it is the "courts' core constitutional authority and duty to ensure that the Arizona Constitution is given full force and effect." *Ariz. Sch. Bds. Ass'n., Inc. v. State*, 252 Ariz. 219, 225 ¶ 22 (2022); *see also Ariz. Indep. Redistricting Comm'n.*, 229 Ariz. 347, 355 ¶ 35 (2012) (emphasizing that it is the judiciary's "duty to interpret and apply the constitutional limits" and maintain "the delicate balance our constitutional framework requires among the branches of government").

While judicial review may seem superficially in tension with legislative supremacy, these two constitutional pillars support the same ultimate end: the liberty of the individual citizen and the security of his property. "The separation of powers doctrine 'protect[s] one branch against the overreaching of any other branch,' and it 'part of an overall constitutional scheme to protect individual rights.'" *Cook v. State*, 230 Ariz. 185, 187 ¶ 6 (App. 2012) (quoting *State v. Prentiss*, 163 Ariz. 81 (1989)). When a court enforces a stricture on the exercise of government power, it fortifies the structural underpinnings of the democratic process.

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The Gift Clause encapsulates this equilibrium between legislative discretion and judicially enforceable rights. Public bodies and officers can claim no title to the land, credit, or other assets of their polity; they merely hold those resources in trust for the ultimate locus of sovereignty in Arizona: the people. *See generally San Carlos Apache Tribe v. Superior Court ex rel. Cnty. of Maricopa*, 193 Ariz. 195, 215 ¶ 52 (1999). While taxation is, of course, the lifeblood of government's existence, it carries with it perilous potentialities for property rights and individual freedom. For that reason, even the Legislature's generally "plenary power over taxation" is "[s]ubject to constitutional limitations." *Waddell v. 38th St. P'ship*, 173 Ariz. 137, 140 (Tax. Ct. 1992). To be sure, the policy decisions of whom or what to tax, the amount or rate of such levies, and the purposes for which the resulting revenues should be disbursed are entrusted largely to the Legislature's judgment. But constitutional safeguards, such as the Gift Clause, that forbid abusive enrichments of favored private actors at taxpayers' expense are paramount. The judiciary honors—rather than undermines—the separation of powers by enforcing them. *See, e.g.*, *Ariz. Sch. Bds. Ass'n*, 252 Ariz. at 225 ¶ 22 (invalidating budget bills that the court found did not comply with the Constitution's single-subject and titling provisions, explaining that "[t]he responsibility of determining whether the legislature has followed constitutional mandates that expressly govern its activities is given to the courts—not the legislature"); *Biggs v. Cooper ex rel. Cnty. of Maricopa*, 236 Ariz. 415, 419–20 ¶ 17 (2014) (holding that dispute over whether Legislature's enactment of alleged new tax complied with constitutional supermajority requirements was justiciable, notwithstanding the potential availability of "alternative political remedies").

In short, while the Defendants are correct that the Legislature possesses expansive latitude to craft tax policy, that leeway ends where the Constitution begins. The Gift Clause lays down an inviolable line: the State may ***never*** "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." If a state outlay—whether denominated a "refundable tax credit" or anything else—traverses that boundary, the Court may and must say so. "When the judiciary fails to

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interpret and enforce constitutional rights and limits, it shrinks from its central duty and drains the Constitution of its intended meaning." *State v. Maestas*, 244 Ariz. 9, 16, ¶ 30 (2018) (Bolick, J., concurring).

II. Refundable Tax Credits for Film Production Are "Subsidies," Within the Meaning of the Gift Clause

A "refundable tax credit" entitles the recipient to a payment of public funds from the government, independent of and without regard to the recipient's actual tax liability. It is, as a matter of law and common sense, a "subsidy," within the meaning of the Gift Clause.

Skirting past these critically distinctive attributes of refundable tax credits, the Defendants sweep them in with what they characterize as an undifferentiated panoply of tax exemptions, deductions, and offsets. *See* Mot. at 9–10. Proceeding from that flawed premise, they shrug off the notion that tax code machinations could ever implicate the Gift Clause, declaring that "because the state does not own the future taxable income of its citizenry, the state cannot give those funds away." *Id.* at 1. It is, of course, one thing for the State to simply leave money or property in the hands of its original owner. For example, the Supreme Court upheld a non-refundable tax credit that allowed taxpayers to offset up to $500 of their income tax liability by donating to school tuition organizations. *See Kotterman v. Killian*, 193 Ariz. 273 (1999); *see also* A.R.S. § 43-1089 (1998). Importantly, the credit could only reduce an extant tax liability. Because the State never possessed or had a ripened legal claim to those funds—and the taxpayers still had to part with the funds (by donating to a student tuition organization) to receive the tax break anyway—no "gift" of government resources could have occurred. *See id.* at 621 ¶ 52.

A "refundable tax credit," such as that established by the Program, carries a far different complexion. The appellation itself is something of a misnomer because it implies that the credit merely reduces a pre-existing tax liability. But the hallmark of a "refundable" tax credit is that "it is paid in cash when a tax unit has no . . . income tax liability to offset." Lily L. Batchelder, Fred T. Goldberg, Jr., and Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 33 (2006).

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Notwithstanding the Defendants' attempt to confound them with tax deductions or exclusions, refundable credits are unique in a key—and, for Gift Clause purposes, dispositive—respect. Whereas a person who has no tax liability to offset "does not obtain any benefit or assistance" from a deduction, a refundable tax credit program—in which any "unused credit [is] paid to the taxpayer"—is "the equivalent of a direct expenditure program." Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 723–24 (1970).

The normative justifications for refundable tax credits vary. Some defend their supposed capacity to incentivize ostensibly desirable social or economic decisions, as well as their relative ease of administrability. *See* Batchelder, *et al.*, *supra*, at 31–32. But they also carry shrewd political utility. Because the lexicon of "tax credits" is more mellifluous to many voters' ears than the terminology of "handouts," interest groups and their allies devising new subsidies often are tempted to "seek the cloak of the tax code" in "the hope that opponents of a generous social welfare state will not find out what we are doing." Dennis J. Ventry, Jr., *Welfare By Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1266 (2007). But cosmetic political nomenclature cannot alter the inescapable fiscal and practical reality that refundable credits represent direct, redistributive expenditures of government funds (*i.e.*, revenues collected from other citizens) to the claimant taxpayer. *See id.* at 1278 (commenting that, "whether we want to admit it or not," the federal refundable Earned Income Tax Credit "operates as a welfare program in terms of its economic effect," despite being administered through the tax system).

Courts can and should heed this distinction when assessing whether a tax credit claimant has received a tangible financial benefit. Several bankruptcy courts, for example, have held that while non-refundable tax credits do not qualify as "public assistance benefits" (which are usually exempt from the bankruptcy estate), refundable credits—by virtue of their character as direct transfer payments—do. *See, e.g.*, *In re Koch*, 299 B.R. 523, 527 (Bankr. C.D. Ill. 2003); *In re Johnson*, 480 B.R. 305, 315 (Bankr. N.D. Ill. 2012) ("The

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refundable nature of the Adoption Tax Credit for tax year 2011 is the key factor in this case. A refundable tax credit, like a payment, can be refunded to the taxpayer by the Internal Revenue Service. In contrast, a nonrefundable tax credit is a credit that can reduce income tax liability to zero, but any remaining credits are not refunded to the taxpayer." (internal citations omitted)); *accord In re Hardy*, 787 F.3d 1189, 1196 (8th Cir. 2015).[1] The point is that, when assessing the legal status of a given transaction, courts cannot permit tendentious labels to displace objective economic facts.

The import of the Defendants' position—*i.e.*, that the government can bypass the Gift Clause merely by funneling a direct payment through an individual or company's tax return—would exalt form over substance and enervate the Gift Clause as a meaningful check on government profligacy. Viewing this case through the prism of recent precedents illuminates the danger. The Supreme Court in *Turken v. Gordon* held that the City of Phoenix violated the Gift Clause when it promised a developer up to $97.4 million in city funds in return for constructing parking facilities on private property. 223 Ariz. 342, 351 ¶ 42 (2010). Under the Defendants' reasoning, however, the State could have consummated an economically identical transaction but evaded the Gift Clause simply by permitting the developer to claim a "refundable tax credit" equal to $97.4 million (or more) for constructing the same parking spaces. Similarly, the government cannot pay a private university to construct a campus for its own students' use. *Schires v. Carlat*, 250 Ariz. 371 (2021). But if the Defendants' theory of the Gift Clause prevails, it is hard to see what would stop the government from simply restructuring the same windfall as "refundable tax credit."[2] The constitutionality of a disbursement of taxpayer funds does not and should not pivot on such artificial distinctions and fiscal optical illusions.

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[1] In marked contrast to the recipients of (for example) the federal Earned Income Tax Credit and similar refundable credits, private motion picture corporations are not susceptible to any plausible characterization as a needy or economically disadvantaged community. *Compare Humphrey v. City of Phoenix*, 55 Ariz. 374, 387 (1940) (finding slum clearance project to benefit low income residents constitutional).

[2] Taking the hypothetical a step further, if (as in *Schires*) the beneficiary was already tax

In sum, in deciding the Motion to Dismiss, the Court should "keep before [it] two principles, (a) the provisions of the constitution prevail over any legislative action, and (b) what the legislature is prohibited from doing directly it may not do indirectly." *Miners & Merchants Bank v. Bd. of Sup'rs of Cochise Cnty.*, 55 Ariz. 357, 359 (1940). A respect for the coordinate branches does not require the judiciary to indulge semantic and accounting gymnastics. A "refundable tax credit" payable to select private business is—legally, practically, and economically—a subsidy.[3]

CONCLUSION

The Court should deny the Motion to Dismiss.

RESPECTFULLY SUBMITTED this 15th day of July, 2025.

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exempt, the government could simply impose a new tax, and then extinguish it for politically favored universities by extending a tax credit that is "refundable" up to the amount of the desired payout.

[3] A transfer can avoid classification of a "subsidy" under the Gift Clause if the recipient provides adequate bargained-for return consideration. *See Turken*, 223 Ariz. at 348 ¶ 21. The Plaintiffs, however, have adequately pleaded that the largesse conferred by the Program on private film production companies is grossly disproportionate to whatever token consideration they furnish to the State in return. *See* Compl. ¶¶ 135–144.

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