



BACKGROUND
FANN, ET AL. v. STATE OF ARIZONA

Executive Summary

Arizona recently adopted Proposition 208, imposing one of the largest tax increases in the state’s history and making Arizona the 10th highest-taxing state in the nation. But Prop. 208 does more than impose a severe tax increase in the midst of a severe nationwide recession—it also violates the state Constitution and deprives the people’s elected representatives of their authority to manage and control the state’s budget.

On November 30, 2020, attorneys at the Goldwater Institute, Snell & Wilmer, and Greenberg Traurig filed suit on behalf of a coalition of taxpayers, legislators, and small business groups to challenge the legality of Prop. 208 and to protect Arizona taxpayers against this illegal and ill-conceived measure.

The Problem

In the fall of 2020, a group of out-of-state unions and special interest groups placed an initiative on the Arizona ballot designed to raise taxes by nearly \$1 billion. Although sold as a measure that would only raise taxes on the rich, in reality the tax falls on middle-class wage-earners, particularly owners of small businesses. In fact, half of the people subjected to the tax would be small business owners.

Moreover, unlike other state taxes that are indexed to inflation, the initiative is pegged to a particular dollar amount, meaning that the Proposition 208 tax will effectively increase with time. And because the tax targets the upper brackets of the state’s income tax—a highly volatile tax base—the initiative is likely to drive businesses out of the state and to slow business growth, resulting in the long term in some 124,000 fewer new jobs over the next decade, and a loss of \$2.4 billion in state and local taxes.¹

But Proposition 208 isn’t just bad economic policy—it’s also illegal.

The Law

Arizona’s Constitution gives voters the power to pass initiatives, but it also imposes important limits on the initiative power. In fact, it expressly provides that “any law which may not be enacted by the Legislature under this Constitution shall not be enacted by the people.”² And the Constitution limits both how taxes may be raised and how government may spend money. Proposition 208, however, ignores or tries to evade these limits.

¹ Matt Beienburg, “Good for Special Interests and Unions, Bad for Arizona: The Economic Impacts of Proposition 208,” Goldwater Institute, Sep. 15, 2020, <https://goldwaterinstitute.org/prop208-bad-for-arizona/>.

² Ariz. Const. art. 22 § 14.

For example, in an effort to limit the state’s spending, Arizona voters passed an initiative in 1986 (Proposition 101) to amend the Constitution in order to control how the state spends money for schools. That initiative creates an “economic estimates commission,” with the responsibility of measuring how much “local revenue” has been received, among other things, in order to set spending for schools.³

Then in 1992, voters again amended the Constitution to restrict how taxes could be raised. Proposition 108 added a provision to the state’s highest law that declared that any and all tax increases had to receive “the affirmative vote of two-thirds of the members of each house of the legislature.”⁴

Proposition 208, however, ignores these restrictions. Most importantly, it does not amend the state Constitution at all but creates a new *statute* instead. But statutes must always fall within the boundaries of the Constitution—and Proposition 208 fails this test.

The new initiative raises taxes without a two-thirds vote of the state legislature, but through a narrow majority of the voting public instead. And in the parts of the initiative governing spending, it declares that money obtained through the new tax increase “are not considered local revenues for the purposes of...[the] Constitution” and are “exempt” from the Constitution’s spending limits.⁵

Because Prop. 208 is not a constitutional amendment but just an ordinary law, it must comply with the state Constitution. And since the legislature could not have adopted language exempting itself from the Constitution’s taxing and spending rules, that means voters could not do so either.

What’s more, Prop. 208 declares that the money raised by the new tax “are in addition to” any allocation that the legislature might make and that the legislature “may not supplant, replace, or cause a reduction in other funding sources.”⁶ That means the already-existing 2020 appropriation for education is locked in place and cannot be reduced. But that conflicts with the legislature’s inherent responsibility to write the state’s budget and decide how to spend money. Given its vague wording—what exactly does it mean to “cause a reduction” in a “funding source”?—it is unclear what effect the initiative will have on taxes and spending on matters that have nothing to do with education. This problem is worsened by the fact that Arizona’s Voter Protection Act makes ballot initiatives essentially unrepeatable and unchangeable by the legislature.⁷ So Prop 208 bars a future legislature from changing the existing education appropriations. This provision of Prop. 208 also conflicts with a section of the Arizona Constitution that expressly *does* allow the legislature to “divert” funds in cases involving initiatives.⁸ Because Prop. 208 is not a constitutional amendment, however, it cannot legally override this constitutional authorization.

The initiative also violates another constitutional provision called the Revenue Source Rule, which says that any time an initiative mandates spending, it must specify a source of revenue to pay for that spending—and this revenue may *not* come from the general fund.⁹ But by forbidding the legislature

³ Ariz. Const. art. 9 § 21.

⁴ Ariz. Const. art. 9 § 22.

⁵ Prop. 208 Section 3 (adding A.R.S. § 15-1285).

⁶ Prop. 208 Section 3 (adding A.R.S. § 15-1284(E)).

⁷ Ariz. Const. art. 4 pt. 1 § 1 (6)(B).

⁸ Ariz. Const. art. 4 pt. 1 § 1 (6)(D).

⁹ Ariz. Const. art. IX § 23.

from “causing a reduction” in existing appropriations, Prop. 208’s spending mandates *do* come from the general fund.

There’s no question that the initiative process plays an important role in Arizona’s constitutional system. Respecting the will of the voters, however, means also respecting the constitutional limits that voters added in 1986 and 1992 that limit both taxes and spending. Voters can, of course, repeal those constitutional limits if they want—but they didn’t do that with Proposition 208, which only creates a statute and does not amend the Constitution.

Case Logistics

The plaintiffs in the case are:

- Arizona Senate President Karen Fann;
- Arizona Speaker of the House Russell “Rusty” Bowers;
- State Senator David Gowan (chairman of the Senate Appropriation Committee);
- State Senator Vince Leach (vice-chair of the Senate Appropriation Committee);
- State Representative Regina Cobb (chairman of the House Appropriation Committee);
- State Representative John Kavanaugh (vice-chair of the House Appropriation Committee);
- State Representative Steve Pierce;
- Montie Lee, owner and operator of Lee Farms;
- Dr. Francis Surdakowski, a cardiac specialist;
- No on 208, which opposed the passage of Proposition 208;
- The Arizona Free Enterprise Club, a nonprofit organization devoted to reducing the income and property tax burden in Arizona, opposing government subsidies, and promoting a competitive and innovative economy in Arizona.

The defendants are the state of Arizona itself, as well as several government officials whose duties include implementing Proposition 208.

The case was filed in the Superior Court for Maricopa County on November 30, 2020.

The Legal Team

Timothy Sandefur is Vice President for Litigation at the Goldwater Institute’s Scharf-Norton Center for Constitutional Litigation.

Jon Riches is the Director of National Litigation for the Goldwater Institute’s Scharf-Norton Center for Constitutional Litigation.

Dominic E. Draye is a shareholder at Greenberg Traurig in Phoenix. Before joining Greenberg Traurig, he served as the Solicitor General for the State of Arizona.

Brett W. Johnson is a partner at Snell & Wilmer. Before joining Snell & Wilmer, he served as a judge advocate in the United States Navy. Assisting him are counsel **Colin Ahler** and associate **Tracy Olson**.

*This backgrounder has been updated.