

**IN THE SUPREME COURT
STATE OF ARIZONA**

JAIME A. MOLERA, an individual and qualified elector; ARIZONANS FOR GREAT SCHOOLS AND A STRONG ECONOMY, a political action committee,

Plaintiffs/Appellees/Cross-Appellants,

v.

KATIE HOBBS, in her official capacity as Arizona Secretary of State; INVEST IN EDUCATION (SPONSORED BY AEA AND STAND FOR CHILDREN), a political action committee,

Defendants/Appellants/
Cross-Appellees

No. CV-20-0213-AP/EL

Maricopa County Superior
Court No. CV2020-007964

**BRIEF OF *AMICI CURIAE* CHANGING HANDS BOOKSTORE, INC.;
BLOCKWISE ENGINEERING, L.L.C.; ACCURATE SIGNS & ENGRAVING, INC.;
E & I VENTURE CAPITAL; AND, RONALD BUTLER, JR.**

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Attorney for Amici Curiae

August 10, 2020

INTERESTS OF *AMICI CURIAE*

Amici curiae (“Business Amici”) urge this Court’s reinstatement of the Invest in Education initiative on the November general election ballot. Over the past 45 years, owners of the Business Amici have started, owned, and operated successful and prominent businesses in Arizona:

- In 1974, Changing Hands Bookstore, Inc. opened its doors. Today, founder and co-owner Gayle Shanks operates two Changing Hands Bookstores and the First Draft Book Bar and is one of the leading independent booksellers in the United States.
- In 2000, Ed Goff founded Blockwise Engineering, which operates as a Subchapter S-corporation from its only facility in Tempe, Arizona, where Blockwise builds equipment for the manufacture of medical devices such as angioplasty balloons and stents.
- In 1991, Jim Mapstead bought Accurate Signs & Engraving, Inc. Accurate Signs, a subchapter-S corporation, is one of the largest manufacturers of laser engraved tags for electrical contractors and solar panel installers in the United States.
- In recent years, along with his business partner, Geoffrey Mobisson, managing director and principal of *amicus curiae* E & I Ventures Capital,

LLC, built and sold a \$100 million business in Chandler, Arizona. Today, E & I Ventures makes investments in early-stage technology businesses.

- Finally, *amicus curiae* Ronald Butler, Jr., CPA, managing partner of the Phoenix office of one of the Big 4 public accounting firms, advises Arizona businesses on tax and other business matters. Mr. Butler is the Chairman of Downtown Phoenix Partnership, the Past Chairman of Arizona Community Foundation, the Past Chairman of Teach for America – Phoenix and Past Co-Chairman of the P20 Education Committee of Greater Phoenix Leadership. He also serves on the Executive Board of Directors of Expect More Arizona (Chair-Elect), Arizona Science Center, and Barrow Neurological Foundation, and is a member of Greater Phoenix Economic Council and University of Arizona Eller College Board of Advisors.

Every year, for decades, Business Amici have hired skilled and highly-educated Arizonans—engineers, accountants, technicians, tool and die makers, and others. A high-quality public education system, they believe, remains key to a strong, sustainable community and economy.

But, as Mr. Mobisson points out, Arizona’s public education system has eroded. Employers elsewhere have noticed. Exh. 1. As he testifies, after selling his business recently, the majority shareholders moved the company from Chandler,

Arizona to Indiana because the sub-par education level of Arizona’s workforce could not sustain the business. Id.

Like thousands of other business owners across Arizona, Business Amici depend upon an educated workforce. They understand that Arizona’s low education funding undermines Arizona’s ability to educate students and strengthen the workforce. Today, Arizona ranks 48th in per-pupil funding. Our pupils deserve better, Business Amici contend, and Arizona’s voters deserve the chance to say so in November.

ARGUMENT

1. **Taxation of income from businesses is a long-standing provision of U.S. tax law, not a ‘principal provision’ of the Initiative.**

Invest in Education (IIE) proposes to put the Invest in Education Act (I-31-2020) on the 2020 general election ballot. In 1991, the Arizona Legislature required that signature sheets of all initiative petitions include summaries of “no more than 100 words of the principal provisions of the proposed measure or constitutional amendment.” A.R.S. § 19-102(A). The relevant portion of the summary of the Invest in Education initiative reads as follows:

“The Invest in Education Act provides additional funding for public education by establishing a 3.5% surcharge on taxable income above \$250,000 annually for single persons or married persons filing separately, and on taxable income above \$500,000 annually for married persons filing jointly or head of household filers[.]* * *”

After hearing three days of testimony and argument, the trial court decided that this portion of the summary omitted five principal provisions of the Initiative (the “Omitted Provisions”).

The trial court dubbed one of the Omitted Provisions—the focus of this brief—the “Business Income Treatment,” which the court described as follows:

* * * c. The fact that the “surcharge” would apply to business income that was passed along to single and joint tax filers whose taxable income exceed the threshold (the “Business Income Treatment”)[.]

MEO, at 4 ¶ 7. The court determined that omission of this fact was fraudulent or substantially confusing to reasonable Arizona voters; the summary therefore did not comply with A.R.S. § 19-102(A).

Under this Court’s pronouncements, in order to succeed, Plaintiffs must demonstrate that the Business Income Treatment was an omitted, principal provision of the Initiative. This Court has defined a “principal provision” to mean “‘most important, consequential or influential,’ ‘chief,’ and ‘a matter or thing of primary importance.’” *Molera v. Reagan*, 245 Ariz. at 291, 297 ¶ 24 (2018) (quoting *Sklar v. Town of Fountain Hills*, 220 Ariz. at 453). In addition, this Court, recently explained:

The description need not be impartial. *See Save our Vote, Opposing C-03-2012 v. Bennett*, 231 Ariz. 145, 152 ¶ 28, 291 P.3d 342, 349

(2013). Nor must the description detail every provision, as the statutorily required disclaimer acknowledges. [A.R.S.] § 19-102(A). However, the description will require us to invalidate the petition if “it is fraudulent or creates a significant danger of confusion or unfairness.” *Save Our Vote*, 231 Ariz. at 152 ¶ 26, 291 P.3d at 349 (citation omitted).

Molera v. Reagan, 245 Ariz. at 295 ¶ 13. The court must “consider the meaning a reasonable person would ascribe” to the summary. *Ariz. Chapter of the Associated Gen. Contractors of American v. City of Phoenix*, 247 Ariz. 45, 48 (2019).

Here, the trial court would require proponents to tell voters that (1) S corporations, nonfarm sole proprietorships, and partnerships (including LLCs) serve as conduits between a business and its owners; (2) these entities are not taxed directly; and, (3) members of these entities face personal tax liability for any income flowing to them from the entity.

But, these are neither “principal” nor even “provisions” of the Initiative. Instead, these are *effects* of the surcharge stemming from features of U.S. tax law. Proponents are not required to describe effects of the Internal Revenue Code. Electors—and all of us—are charged with understanding the law. No summary need describe all potential effects of a measure. *Save Our Vote*, 231 Ariz. at 152 ¶ 27. A summary is not misleading “only because it is incomplete.” *Kromko v. Superior Court*, 168 Ariz. 51, 60 (1991).

2. The trial court ignored widely-known information in concluding that Arizona voters would be confused by the term “taxable income” in the summary.

The trial court complained that “[t]he 100-word description does not alert signers that this “pass through” “business” income from sole proprietorships, limited liability companies, S-corporations, and partnerships, which is not paid at the business level, would pass through and be subject to the “surcharge” if it was part of an individual or married couple’s taxable income exceeding the applicable threshold. MEO, at 6-7 (¶ 9). The court explained that “[o]mitting any reference to Business Income Treatment created the substantial danger that a reasonable Arizona voter failed to appreciate that business “pass-through” income would be subject to this new tax.” MEO, at 8 (¶ 11).

In reaching this conclusion, the trial court ignored widely-available information. Today, for example, across the internet, the Small Business Administration¹ and many other websites describe exactly these points.²

¹ <https://www.sba.gov/sites/default/files/rs343tot.pdf> at 39 (“Flow-through entities are not subject to federal income tax, but are instead allowed to “flow” the business profits through to the owners of the business.”).

² E.g., <https://www.freshbooks.com/hub/accounting/how-much-do-small-businesses-pay-taxes>.

The court also ignored expert trial testimony. During the three-day bench trial, Prof. John Swain, a tax law expert and member of the faculty at the University of Arizona College of Law, testified as follows: “No business entities are subject to the surcharge.” Trans. Court Trial Day 3 (PM Only): 64:2-3 (7.30.20). Federal and state tax law require that pass-through income must be reported as taxable income by *individual* filers, as Prof. Swain explained:

“[T]he income tax of businesses are taxed to their owners. Like the income of a partnership is taxed to the owner. Or an income of a single member LLC is taxed with the owner[.]”

Day 3: 67: 8-11. The same is true, he testified, for S corporations and sole proprietorships. Id.: 67: 13-19. *Amicus curiae* Mr. Butler and his firm advise businesses around Arizona and nationwide. He explains in part as follows:

* * * It is well-known that taxable income at the individual level may include pass-through income from sole proprietorships, limited liability companies (LLCs), S-corporations and partnerships. Internal Revenue Code Section 61 sets out several items that are included in an individual’s income including compensation from employment and income derived from business. While this income is defined as such at the federal level, Arizona Revised Statutes § 43-102.A.1 specifically links the definition of income to the Internal Revenue Code and provides that an individual’s federal adjusted gross income is the starting point in determining Arizona individual taxable income.

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/ / /

The entities in question in this case are established as non-taxable entities by the individual(s) setting up the business. It is clearly understood that income allocated to the individual from these types of entities is taxable at the individual level in accordance with the applicable tax statutes. * * *

Exh. 2. During the three-day trial, not one witness testified that the summary overlooked an important provision of federal tax law. Plaintiffs submitted no survey evidence on this point (perhaps because this information is widely known). And, so, without citation to the record, and in the teeth of widely-available information, the trial court asserted that voters would not understand that “taxable income” included “income from flow-through businesses.”

3. **Long-standing decisional law confirms that the summary need not ‘explain all potential effects’ of the Initiative.**

Set aside for one moment Plaintiffs’ burden; the contrary public information; and, absence of support for the trial court’s view in the record. It would be one thing if, as in *Molera*, the summary contradicted the effects of the Initiative on taxpayers. But it does not. And this Court has “never required an initiative description to explain all potential effects of a measure[.]” *Associated Gen. Contractors*, 247 Ariz. at 49 ¶ 18. Yet the trial court demanded exactly that: tell the electors that “flow-through” business income would be subject to the surcharge.

The claimed omission of an effect brings this case most closely to *Wilhelm v. Brewer*, 219 Ariz. 45 (2008). There, the initiative would have created a 10-year warranty on new homes and enhanced homeowners’ rights concerning construction defects. The summary omitted that the initiative would extend the statute of repose on defect claims from eight to ten years. The challenger argued that made the summary misleading. This Court disagreed. Excluding the statute of repose extension from the summary “was not fraudulent and did not create confusion or mislead. The proponents included the warning required by the legislature and informed signers that the summary had been prepared by initiative supporters and advised them to review the entire measure.” *Id.* at 48 ¶ 14.

CONCLUSION AND REQUEST FOR RELIEF

Only two years ago, this Court once again confirmed its “great[] respect [for] the initiative process, *Molera*, 245 Ariz. at 293, ¶ 1, and now confronts another effort to overturn the fruits of that process. After review, the Secretary of State approved 377,456 signatures in support of the Initiative—well more than the 237,645 valid signatures required to put the proposition on the ballot. There is no dispute that supporters have enough valid signatures.

Business Amici urge this Court to turn back Plaintiffs’ challenge to the Invest in Education Initiative. Initiative sponsors “compl[ied] with the appropriate

regulation of the initiative process.” *Molera*, 245 Ariz. at 294 ¶ 10. The summary’s omission of the Business Income Treatment is neither fraudulent nor does it create a significant danger of confusion or unfairness. This Court should reverse.

RESPECTFULLY SUBMITTED this 10th day of August, 2020.

SHAWN AIKEN, PLLC



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*Attorney for Amici Curiae Changing
Hands Bookstore, Inc. (Tempe and
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Accurate Signs & Engraving, Inc., E & I
Venture Capital, and Ronald Butler, Jr.*

NOTICE OF ELECTRONIC FILING

The foregoing *Brief of Amici Curiae* was electronically filed this 10th day of August, 2020 using the AZ Turbo Court electronic filing system and was served as indicated in the separate *Certificate of Service* electronically filed this same date.

CERTIFICATE OF COMPLIANCE

This *Certificate of Compliance* concerns:

1. An *amici curiae* brief and is submitted under ARCAP 16(b)(4).
2. The undersigned certifies that the brief to which this certificate is attached, including the attached declarations, uses type of at least 14 points, is double-spaced, and contains 2689 words.
3. The document to which this Certificate is attached does not exceed the word limit (3000) set by the Court's order dated August 3, 2020.

A handwritten signature in cursive script that reads "Shawn K. Aiken". The signature is written in black ink and includes a horizontal line with a small arrowhead pointing to the right at the end.

Shawn K. Aiken

EXHIBIT 1

IN THE SUPREME COURT OF ARIZONA

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Maricopa County Superior Court
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DECLARATION OF GEOFFREY MOBISSON

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Attorney for Amici Curiae Changing Hands Bookstore, Inc. (Tempe and Phoenix), Blockwise Engineering, L.L.C., Accurate Signs & Engraving, Inc., E & I Venture Capital, and Ronald Butler, Jr.

I, Geoffrey Mobisson, declare as follows:

I am a long-time resident of and business founder living in Arizona. My business, E & I Ventures, is a Capital Advisory Firm focused on equity and debt investments in early-stage technology businesses. We are drawn to companies that are undergoing a transition, either operational or strategic, that we believe we can help navigate. E & I was founded by me and Doug Guilbeau following our successful founding of and exit from Lev Digital, a digital experience consultancy. I have reviewed the trial court order in this case and prepared the statement below for assistance to the Arizona Supreme Court.

The InvestInEd ballot proposal represents a critical investment in education that is needed to protect Arizona businesses, their employees, and the economic future of our citizens. My interests in this proposal are transparent, economically focused, pragmatic, and as a technology entrepreneur that has employed hundreds of citizens. My business partner (another Arizona product) and I spent 10 years building a \$100M technology services firm, Lev Digital (now part of Cognizant Inc.) in the middle of downtown Chandler, only to watch the entire operation get moved out of state by the majority shareholders. The reason? Lack of an educated workforce and robust public school infrastructure.

They moved everything to Indiana. Arizona lost high-paying jobs and, more importantly, lost the opportunity to incubate another generation of technology,

business and community leaders. Every day, I watch on social media as my old employees effect change in Indiana: investing in communities, participating in charitable events, doubling down on apprenticeships. This should have been here in Arizona. We lost this not because of money or taxes, we lost it because we don't invest in education. I cannot stress enough how important education and a local government's commitment to it is to technology firms. We need not only smarter local talent, but we also need to be able to attract high-value workers to settle and plant roots in the state.

Don't be fooled by the influx of workers from California and other markets. We are losing our most talented folks and our best leaders every day. Our lack of investment in public education isn't part of the problem. It is the entirety of the problem. We can be stingy about everything else, but not this. InvestInEd begins to put a tourniquet on a profusely bleeding wound.

I declare under penalty of perjury that the foregoing is true and correct.

RESPECTFULLY SUBMITTED this 6th day of August, 2020.

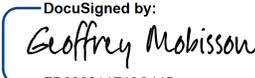
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Geoffrey Mobisson

EXHIBIT 2

IN THE SUPREME COURT OF ARIZONA

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DECLARATION OF RONALD BUTLER

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and Phoenix), Blockwise Engineering,
L.L.C., Accurate Signs & Engraving,
Inc., E & I Venture Capital, and Ronald
Butler, Jr.*

I, Ronald Butler, Jr., declare as follows:

I am a Certified Public Accountant licensed in Arizona. I am a partner in and manage the Phoenix office of a Big 4 public accounting firm. I have reviewed the trial court order in this case and prepared my own statement (below) on the tax issue described in the order.

It is well-known that taxable income at the individual level may include pass-through income from sole proprietorships, limited liability companies (LLCs), S-corporations and partnerships. Internal Revenue Code Section 61 sets out several items that are included in an individual's income including compensation from employment and income derived from business. While this income is defined as such at the federal level, Arizona Revised Statutes § 43-102.A.1 specifically links the definition of income to the Internal Revenue Code and provides that an individual's federal adjusted gross income is the starting point in determining Arizona individual taxable income.

The entities in question in this case are established as non-taxable entities by the individual(s) setting up the business. It is clearly understood that income allocated to the individual from these types of entities is taxable at the individual level in accordance with the applicable tax statutes. This is not a tax on business, but rather this is a tax on individual taxable income. The business owner made a conscious election to be organized as a sole proprietorship, LLC, S-corporation or

partnership. These entities were specifically established to create a single level of taxation to the individual and these types of entities report all business income or losses on the personal income tax return; the business itself is not taxed separately. Federal and state tax authorities call this “pass-through” taxation because business profits and losses pass through the business to be taxed on the personal tax return.

I declare under penalty of perjury that the foregoing is true and correct.

RESPECTFULLY SUBMITTED this 6th day of August, 2020.

By  70890CEA548B419...
Ronald Butler, Jr.