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INVESTIGATION ANALYSIS

Avoiding Constitutional Flaws of GPLET Leases *State and cities should adopt economic policies benefitting all businesses*

By Clint Bolick, Litigation Director

My colleague Mark Flatten has ably documented the abuse of Government Property Lease Excise Taxes, or GPLETs, which cities are using as incentives for well-connected developers. Under this scheme, government takes ownership of buildings used by private enterprises, which eliminates their property taxes. The private enterprises instead pay excise taxes, which amount to a fraction of the property taxes they would otherwise pay—and in many instances, no property taxes whatsoever. In some cases, the favored businesses pay below-market rents as well.

GPLET deals tend to shift the property tax burden to other business and residential taxpayers — and to the State of Arizona, which is mired in budget crisis. Also, the scheme raises serious legal questions, especially in light of the Arizona Supreme Court's recent decision in *Turken v. Gordon*.

Turken centered on whether cities can use financial incentives to lure businesses. While the decision allowed the City of Phoenix's subsidy agreement with the CityNorth development to stand because past legal precedents were confusing, the Supreme Court set forth clear legal rules for future government economic development agreements. Specifically, the beneficiaries must provide tangible direct benefits to the city that are roughly commensurate with the amount

of the city's investment.

Under those rules, GPLETs are legally suspect because the contracts typically obligate the businesses to do nothing other than lease the building and pay rent. The taxes received under the GPLET are far below what the businesses would pay without the agreements. Moreover, by giving favored treatment to some businesses that is unavailable to others that are similarly situated, GPLET deals may violate the constitutional prohibition against special laws and the guarantee of equal privileges and immunities under law.

GPLET legislative reform proposals may not cure the constitutional defects. The court emphasized in *Turken* that compliance with a statutory scheme is not the same as complying with the constitution. Shortening the time period for GPLET leases, ending the zero-tax rate at the end of the lease period, and increasing GPLET tax payments are all steps in the right direction. But if the benefits to taxpayers are not equivalent to the costs, such deals will be vulnerable to legal challenges.

Some contend that if GPLETs are curbed, Arizona will lack economic development tools to effectively compete with other states. However, a far better and more equitable alternative is a tax and regulatory climate that is conducive to *all* businesses, including start-ups and small businesses.

Specifically, the Goldwater Institute has recommended that commercial property tax rates be lowered to the same rate as residential property taxes. Likewise, enterprise zones that provide tax relief to an entire blighted area are preferable, both constitutionally and from a policy perspective, to singling out properties on a case-by-case basis—so long as the zones are rationally created and not intended to benefit specific businesses.

Business-friendly tax and regulatory policies are not the same as preferential treatment to some at the expense of others. As Mark Flatten demonstrates, Arizona governments have been doing too much of the latter as a substitute for sound tax policy. Fortunately, the Arizona Constitution strictly limits preferential schemes. We should curtail such schemes and address the more difficult, yet far more productive task, of creating sound, fair, and equitable economic development policies.

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