



BACKGROUNDER *PAULIN v. PHOENIX*

Executive Summary

In the heart of downtown Phoenix—in one of the most desirable real estate markets in the state—the City of Phoenix has agreed to an elaborate tax scheme to relieve one private real estate developer, the Hubbard Street Group, of \$7.9 million in property taxes that the Developer would otherwise owe.

Utilizing the Government Property Lease Excise Tax (GPLET) abatement provisions of Arizona law,¹ the City has agreed to take over the legal title to the Hubbard Project so that the property technically becomes “government property,” and thus excluded from the tax rolls—while leasing the property back to Hubbard, which enjoys the full power to manage the property and profit it from it just like any other private business. This legal shell game allows Hubbard to pay no property taxes on the project for eight years, while other Arizona taxpayers—in Phoenix and beyond—have to shoulder the difference. Then, when the eight-year lease expires, the City turns the property back over to Hubbard.

The Arizona Constitution prohibits cities from giving subsidies to preferred businesses and forbids the conveyance of property for the purpose of evading taxation. To vindicate the rights of Arizona taxpayers and enforce our state Constitution, Goldwater Institute attorneys are representing Phoenix taxpayers in a lawsuit to put a stop to Phoenix’s GPLET abuse.

Background

Local governments are exempt from property taxes under the Constitution. That means that if the government leases its own property to a private business, the government would otherwise be denied a revenue stream. Arizona therefore adopted its GPLET law in 1996,¹ to allow cities, towns, counties, and county stadium districts to collect a lease excise tax when it leases its property to a money-making business.

¹ A.R.S. §§ 42-6201 – 42-6210.

But in practice, local governments routinely abuse their powers under the GPLET law in order to give sweetheart deals to private businesses—which fosters cronyism and raises the proportionate tax burden of other taxpayers.

It works this way: by taking technical ownership of private property—which ordinarily would be subject to property taxes—and then leasing it back to the private party, while allowing that private party full control over the property, the government can create a special tax break for the lessee that in practice is identical to handing over a cash subsidy. The result is a lower revenue stream for the government, and an effective tax increase for local residents—but politicians can take credit for the fact that a new business has opened in town, and the business enjoys a cushy tax write-off.

Cities can also abate property taxes altogether for eight years if the property is in a “slum or blighted area” within a central business district.² But although that was intended as a way to encourage businesses to improve depressed locales, the fact is that municipalities have been pushing the boundaries of “slum or blight” for decades. Today, GPLET tax abatements are even available in some of the highest-priced real estate locations in Arizona. That includes the Hubbard Project, located in a bustling, highly trendy area of downtown Phoenix.

Hubbard currently pays property taxes on vacant parcels of land that it owns. But it will no longer be required to do so after it builds the Hubbard Project, a 26-story multi-family residential development located on the southeast corner of Sixth and Garfield Streets in downtown Phoenix. The construction costs for the Hubbard Project are estimated at \$86.9 million. Hubbard expects at least a 5.56 percent return on the Project, but the City has agreed to *increase* its profits to 6.51 percent through a taxpayer-financed abatement and reduction of property tax.

The City entered into a development agreement with Hubbard that relieves the developer of its existing property tax burden for eight years through the type of shell game described above. The Developer and the City estimate that the value of this tax abatement over the course of the eight-year lease is more than \$6.6 million—but it is likely approximately \$7.9 million.

In exchange for that multi-million dollar tax abatement, Hubbard agrees to pay the City \$525,000 in rent payments, as well as \$32,000 in payments to two school districts, and to dedicate ten percent of the residential units of the development for “Workforce Housing”—but only during the eight years of the lease.

² A.R.S. § 42-6209.

The Law

The Arizona Constitution prohibits governments from subsidizing private businesses and prohibits the conveyance of property for the purpose of evading taxes that would otherwise be due. The GPLET subsidy in the Hubbard Project violates both of these provisions.

Gift Clause

The Arizona Constitution's Gift Clause forbids the state and its subdivisions from "mak[ing] any donation or grant, *by subsidy or otherwise*, to any individual, association, or corporation."³ As the state's courts have explained, the purposes of the Gift Clause are to prevent the "depletion of the public treasury or inflation of public debt by [public entities] engag[ing] in non-public enterprise,"⁴ and to prevent government entities from "giving advantages to special interests."⁵

In cases involving the Gift Clause, Arizona courts have said that the government may only give taxpayer money to a private entity if (1) doing so serves a public purpose and (2) the private party gives back "proportionate consideration"—a term which means that the recipient of public funds gives goods or services back to the public that are of equivalent value to the money the private party receives.⁶ More simply, government can *buy* things from private parties—but cannot give money away, or spend so much for things of small value that the expenditures become the equivalent of a gift.

The Hubbard Project fails this simple test. For one thing, the City receives inadequate consideration in exchange for its \$7.9 million subsidy to Hubbard. The arrangement also fails to achieve public purpose because the favorable tax treatment benefits only the Developer, not the public, and the City doesn't exercise sufficient control over the operations of the Hubbard Project to ensure that any public purpose is accomplished.

In fact, in June 2020, a Maricopa County Superior Court Judge struck down a nearly identical GPLET subsidy that Phoenix gave to the developer of another high-rise residential building.⁷ In that case, the Court observed:

If Arizona law prohibits grossly disproportional benefits to be paid to a developer, and if payments under a future GPLET agreement must more

³ Ariz. Const. art. IX, § 7.

⁴ *Town of Gila Bend v. Walled Lake Door Co.*, 107 Ariz. 545, 549 (1971).

⁵ *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984).

⁶ *Schires v. Carlat*, 250 Ariz. 371, 374 (2021).

⁷ *Englehorn, et al. v. Stanton, et al.*, CV 2017-001742, at 18 (Maricopa Cty. Sup. Ct., June 18, 2020).

closely approximate the amount of *ad valorem* taxes, does the GPLET have any remaining usefulness to incent redevelopment? In other words, this judicial officer questions whether the death knell for the GPLET's usefulness has rung.⁸

Yet, despite that admonition, less than four months later, the City approved this GPLET tax abatement without ensuring that taxpayers receive appropriate consideration.

Conveyance to Evade Taxation

Voters amended the Arizona Constitution in 1980 to prevent the transfer of property to evade the payment of taxes. Under the Evasion Clause, “[n]o property shall be exempt [from property taxes] which has been conveyed to evade taxation.”⁹

But the express purpose and the intention of the City and Hubbard in entering the development agreement, however, is to relieve Hubbard for eight years of its obligation to pay property tax that it would otherwise have to pay.¹⁰ In other words, the *stated* goal of the agreement is to evade taxation. The developer is conveying its property to the City—on which it would otherwise be liable for taxes—and the City is accepting that conveyance for a reason the Constitution prohibits.

Taxpayers brought this case to enforce the constitution's prohibition on unlawful subsidies and to protect taxpayer resources that they have an obligation to replenish.

Case Logistics

The plaintiffs in this case are Bramley Paulin and Mat Englehorn. They and their businesses are Phoenix taxpayers responsible for paying property, sales, and other taxes, and they bear a share of the tax burden and are liable for replenishing the public coffers for unlawful government subsidies.

The defendants are the City of Phoenix and the Phoenix City Manager, acting in his official capacity.

The case was filed in the Superior Court of Arizona in Maricopa County on May 4, 2022.

⁸ *Id.*

⁹ Ariz. Const. art. IX, § 2(12).

¹⁰ Disposition and Development Agreement between the City of Phoenix, Arizona, and Hubbard Street Group at § 303.

The Legal Team

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