

Legal Q&A

By **Bill Longley**, TML Legislative Counsel

Why has the passage of H.B. 157 in 2015 generated so much interest amongst cities?

H.B. 157, which passed in 2015 and became effective September 1, 2015, provides that: (1) a city may hold an election to impose a dedicated city sales and use tax for sports and venue districts, crime control and prevention districts, economic development corporations, property tax relief, or street maintenance at any rate that is an increment of at least one-eighth of one percent and that would not result in a combined rate that exceeds the maximum local sales and use tax rate of two percent; and (2) a city may hold an election to impose its general revenue sales and use tax at any rate that is an increment of at least one-eighth of one percent and that would not result in a combined rate that exceeded the maximum local sales and use tax rate of two percent.

In other words, the bill authorizes a city to hold an election to *reallocate sales tax revenue* within the two percent local sales tax cap. By doing so, it allows a city to determine whether dedicated sales taxes should be increased or decreased, or whether a general revenue sales tax better serves its needs.

What is the maximum sales tax rate that can be charged on a sale of taxable goods or services in the state?

The sales tax rate charged by the state on the sale of each taxable item in the state is 6.25 percent of the sales price of the taxable item. TEX. TAX CODE § 151.051. On top of the state's 6.25 percent sales tax rate, local taxing entities (cities, counties, transit authorities, and special purpose districts) can collectively claim an additional two percent tax rate for a total maximum tax rate of 8.25 percent in any given location. *See* TEX. TAX CODE § 321.101(f). Whether or not the sales tax rate is "maxed out" in a given city depends on what sales taxes have been adopted by the city, in addition to what sales taxes have been adopted by the other taxing entities that overlap with the city.

What is the sales tax for general revenue?

The sales tax for general revenue is a tax that may be levied by a city on all taxable items sold in the city. The revenues from the tax may be spent on almost any lawful purpose of the city.

When the legislature authorized cities to adopt a general revenue sales tax in 1967, it provided that the rate of the general revenue sales tax must be set at one percent—no higher and no lower. After initial adoption of a general revenue sales tax, cities had no authority to call an election to raise or lower the one-percent general revenue sales tax.

This general structure remained in place until 2015. With the passage of H.B. 157, a city is now authorized to hold an election to impose its general sales tax at any rate that is an increment of at least one-eighth of one percent and that would not result in a combined rate that exceeded the maximum local sales and use tax rate of two percent. TEX. TAX CODE § 321.103(a). In other words, a city with an existing one-percent general revenue sales tax may now order an election to increase or decrease the tax, assuming that there is room under the two-percent local sales tax cap for any potential increase.

The sales tax for general revenue is adopted by an election of the city voters. TEX. TAX CODE § 321.101(a). A sales tax for general revenue election may be called by either of two methods: (1) the city council can call the election by adopting an ordinance by majority vote of its own members; or (2) the city council must call the election if it receives a petition signed by at least 20 percent of the number of qualified voters who voted in the most recent regular city election. TEX. TAX CODE §§ 321.401 and 321.101(c).

A city may adopt additional sales taxes beyond the general revenue sales tax, but all such additional sales taxes are for dedicated purposes, and not for general revenue.

What are sales taxes for dedicated purposes?

All city sales taxes, other than the sales tax for general revenue, would be considered sales taxes for dedicated purposes. As the name implies, each of these taxes may only be spent on certain, or dedicated, items or projects. Cities may have a mix of different dedicated taxes, in addition to the general revenue sales tax, so long as the total tax rate in the city does not exceed 8.25 percent.

Prior to the passage of H.B. 157, dedicated sales taxes were capped at certain amounts. For instance, an economic development corporation sales tax could not exceed one-half of one percent. Similarly, the street maintenance sales tax could not exceed one-fourth of one percent. House Bill 157 essentially removes the rate caps on the dedicated sales taxes for venue districts, crime control and prevention districts, economic development corporations, property tax relief, and street maintenance, and authorizes a city to hold an election to increase or decrease these dedicated sales taxes in any increment of one-eighth of one percent.

A dedicated sales tax may be adopted only by a vote of the citizens at an election. An election to adopt a dedicated sales tax generally cannot be held earlier than one year after the date of any previous sales tax election in the city. TEX. TAX CODE § 321.406, *see also* Tex. Att’y. Gen. LO-98-074 (1998).

Our city is “maxed out” at the two-percent sales tax cap. Can we hold an election to switch from one dedicated sales tax to another?

Yes. A city may hold an election to repeal or lower one dedicated sales tax, and raise or adopt a different sales tax, all with one combined ballot proposition. TEX. TAX CODE § 321.409. The fact that this can be accomplished by one combined ballot proposition protects the city’s interest by

eliminating the risk that one tax will be voted out by the citizens without the other tax being voted in. A combined ballot proposition must be worded to contain substantially the same language required by law for each of the two taxes individually. TEX. TAX CODE § 321.409(b).

Note that the law only authorizes a city to use a combined ballot proposition when switching from one dedicated city sales tax to another dedicated city sales tax. If a city wished to lower or repeal a dedicated city sales tax and replace it with an increased general revenue sales tax, the city would need to use two separate ballot propositions to do so.

Can city sales taxes be collected in a city's extraterritorial jurisdiction (ETJ)?

No, but with one exception. The dedicated sales tax to support a municipal development district (MDD) may be collected in a city's ETJ. TEX. LOC. GOV'T CODE § 377.002. An MDD sales tax closely resembles a Type B economic development corporation (EDC) sales tax in that the revenue generated from the tax can be spent for similar economic development projects. One advantage of an MDD sales tax over an EDC sales tax is that the tax may be levied in all or part of the corporate limits of the city, in addition to all or part of the city's ETJ, depending on how the city draws the boundaries of the MDD. *Id.* An EDC sales tax, on the other hand, can only be levied throughout the entire corporate limits of the city. TEX. LOC. GOV'T CODE §§ 504.252 and 505.252.

If a city wants to replace an EDC sales tax with an MDD sales tax, can it use a combined ballot proposition?

Although a city is permitted to have a combined ballot proposition to switch from an EDC sales tax to a MDD sales tax, doing so could create a unique problem. If the boundaries of a proposed MDD are to include all or a portion of the city's ETJ, then the MDD would cover a different taxing area than would the EDC. As a result, the combined ballot proposition would either: (1) allow voters living outside the city limits in the ETJ to vote to terminate the EDC sales tax that was never imposed on them in the first place; or (2) would allow voters inside the city limits to impose the MDD sales tax in an area in which the actual residents living in that area did not have the opportunity to vote.

In at least one instance, the comptroller's office refused to honor the results of a combined ballot proposition to replace the EDC sales tax with the MDD sales tax because the city permitted voters in the ETJ to vote on the proposition that would (in part) abolish the EDC sales tax, even though that tax was never imposed in the ETJ. Because the comptroller has taken this position in the past, a city should consider using two separate ballot propositions if the boundaries of the MDD will differ at all from the boundaries of the EDC.

It is important to point out that H.B. 157 did not affect MDD sales taxes. Consequently, the rate of an MDD sales tax must still be one-eighth, one-fourth, three-eighths, or one-half of one percent. TEX. LOC. GOV'T CODE § 377.103.

What is the process for terminating an EDC and EDC sales tax, or raising or lowering the tax?

Procedures for terminating EDCs and their sales taxes, or raising and lowering the tax, vary by the type of sales tax and the date of adoption. City officials should consult their city attorney, or call Bill Longley, TML Legislative Counsel, at 512-231-7400.

Can the city replace a county, transit authority, or special purpose district's sales tax with a city sales tax (general or dedicated)?

No. A city may not adopt or increase a sales tax if the adoption or increase would result in the combined rate of all sales taxes imposed by local taxing entities having territory in the city to exceed two percent at any location. TEX. TAX CODE § 321.101(f). Therefore, if the county, transit authority, or special purpose district has adopted a sales tax, that tax would claim a percentage of the total two-percent local sales tax cap, and could not be taken away by the city or any other taxing entity within the jurisdiction. A taxing entity would have to voluntarily relinquish its portion of the sales tax (generally through an election to reduce or repeal the tax) in order to free up a portion under the local two-percent cap for another local taxing entity to claim.

Nonetheless, if city voters approve an adoption or increase of a city sales tax on the same election date as voters also approve an adoption or increase of sales taxes for another taxing entity with overlapping jurisdiction, the city's tax generally takes effect over the tax of the other entity. *See, e.g.*, TEX. TAX CODE § 321.101(f); TEX. HEALTH & SAFETY CODE 775.0751(d); TEX. TRANSP. CODE 451.405(b).