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Legal Q&A

By Bennett Sandlin, *General Counsel*

Q: How do we raise our city's one percent sales tax for general revenue?

A: You can't. The city sales tax for general revenue, if adopted, is set at one percent—no higher or lower. A city may adopt additional sales taxes beyond the one percent tax, but all such additional sales taxes are for dedicated uses, and not for general revenue. Examples of additional sales taxes for dedicated uses include economic development, property tax relief, crime prevention, and street maintenance.

Q: How many additional dedicated sales taxes may our city adopt?

A: All local sales taxes combined must total no more than two percent at a given location. Once the one percent general revenue sales tax is accounted for, a city will have at most one additional percent to work with under the "two percent cap," as it's known. Because counties and special districts sometimes adopt local sales taxes, and because all such taxes count against the two percent cap, a city might have less than one additional percent available for its own dedicated sales taxes.

Q: Our city is "maxed out" at the two percent sales tax cap. We've been told in the past that switching from one dedicated sales tax to another is cumbersome and risky. Is this true?

A: Not any more. TML priority legislation passed in 2005 permits a city 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 ANN. § 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.

Q: How do we word a combined sales tax ballot proposition?

A: The statute requires that the wording of the combined proposition contain substantially the same language required by law for each of the two taxes individually. TEX. TAX CODE ANN. § 321.409(b). To make sure that the city properly words its ballot proposition, local legal counsel should be consulted. At least one Texas city has already taken advantage of this new statute, and the TML Legal Department (512-231-7400) can provide samples of such combined propositions.

Q: May the city's general revenue sales tax be pledged to pay off bonds?

A: Generally not. TEX. TAX CODE ANN. § 321.506. Excepted from this prohibition, however, are certain sports and community venue projects. Id. at § 321.508.

Q: May the city's dedicated sales taxes be pledged to pay off bonds?

A: Yes, most can. A city should consult bond counsel prior to attempting to pledge a dedicated sales tax to the repayment of debt.

Q: Our city is contemplating an economic development sales tax. However, we've heard that such taxes are no longer helpful in giving direct incentives to retail businesses. Is this true?

A: It depends on the size of the city, or the revenues of the economic development corporation. Legislation passed in 2003 cancelled the ability of all 4A and 4B sales tax corporations to give direct incentives to retail businesses. Legislation passed in 2005 restores retail authority for 4B corporations (but not 4A corporations) in either of the following circumstances: (a) the city has less than 20,000 population, or (b) the corporation receives less than \$50,000 a year in 4B sales tax revenues for each of the prior two years. TEX. REV. CIV. STAT. ANN. art. 5190.6, § 4(B)(a)(2)(F) and 4(B)(a)(3). Also, certain corporations located near Mexico, and certain "landlocked" cities in large urban areas, are once again eligible to promote retail business.

Q: Our city isn't sure that we're receiving all the sales taxes we are due from the comptroller. For instance, there is a business on the edge of town with an out-of-town address. I don't think they are collecting city sales taxes. What can we do?

A: Making sure cities receive proper sales taxes from businesses located within the city is known as "sales tax allocation." Though the comptroller employs over a dozen allocation specialists, the sheer volume of sales tax applications submitted by businesses necessitates that the initial determination about sales tax allocation comes from the face of the application itself. This leads to occasional errors, typically about whether a business is located within or outside a city.

Cities concerned about proper allocation should: (1) familiarize themselves with the various sales tax reports and lists available from the comptroller; (2) contact the comptroller about specific allocation concerns toll free at 1-800-531-5441, ext. 34530; (3) consider requiring a copy of a sales tax permit as a condition of issuing a certificate of occupancy or other permit to a business; (4) make sure that city maps and city limit descriptions are as clear and up-to-date as possible; and (5) notify the comptroller immediately whenever city boundaries change.