

REVENUE MANUAL FOR TEXAS CITIES

This manual covers nearly every known source of revenue available to Texas cities. The material is presented in a simple question-and-answer format. Many of the questions and answers presented come directly from questions routinely received by the TML Legal Department.

The manual is organized alphabetically by type of revenue. Within each section, very basic questions are addressed first: what is this revenue source; how is it adopted; which types of cities can adopt it; how much can it generate; etc. Accordingly, the manual should be useful to city officials and staff first as a source of new revenue ideas, and then as a basic how-to guide for each source of revenue. Extensive footnotes citing the location of each revenue source within Texas law should make the manual useful to city attorneys, as well.

Because debt must ultimately be repaid by a city, it isn't a source of revenue in the conventional sense. Nevertheless, this manual covers the basics related to various sources of debt funding or financing.

TABLE OF CONTENTS

ALCOHOLIC BEVERAGE TAX.....	1
ANTICIPATION NOTES.....	3
ASSESSMENTS	4
BANK LOANS.....	8
BINGO PRIZE FEES.....	9
BONDS	10
CEMETERY TAX.....	14
CERTIFICATES OF OBLIGATION.....	14
CHILD SAFETY FINES.....	17
COIN-OPERATED MACHINE TAX	18
CREDIT CARD REIMBURSEMENT FEES	19
DONATIONS	19
DRAINAGE FEES	21
FELONY FORFEITURE FUNDS	25
GRANTS	28
HOTEL OCCUPANCY TAXES	29
IMPACT FEES	33
INTERLOCAL AGREEMENTS.....	39
INTERNET PAYMENT AND ACCESS FEES	41
INVESTMENTS	42
LOCAL CONSOLIDATED COURT FEE.....	47
MUNICIPAL COURT FINES.....	50
MUNICIPAL DEVELOPMENT CORPORATION SALES TAX	51
MUNICIPAL DEVELOPMENT DISTRICT (MDD)	52
SALES TAX	52
OPEN RECORDS CHARGES.....	58
PROPERTY TAX FOR GENERAL REVENUE	60
PROPERTY TAX ON NON-INCOME PRODUCING TANGIBLE PERSONAL PROPERTY	74
PRO RATA FEES	75
RAFFLES.....	76
RIGHT-OF-WAY RENTAL FEES	77
RIGHT-OF-WAY RENTAL FEES ON CABLE TELEVISION AND OTHER VIDEO SERVICES	78
RIGHT-OF-WAY RENTAL FEES ON ELECTRICITY.....	80
RIGHT-OF-WAY RENTAL FEES ON GAS AND WATER.....	81

RIGHT-OF-WAY RENTAL FEES ON SMALL CELL NODES.....	82
RIGHT-OF-WAY RENTAL FEES ON TELEPHONE (TELECOMMUNICATIONS) SERVICE	84
SALES TAX FOR CRIME CONTROL	85
SALES TAXES FOR DEDICATED PURPOSES	87
SALES TAX FOR ECONOMIC DEVELOPMENT	89
SALES TAX FOR GENERAL REVENUE.....	91
SALES TAX FOR PROPERTY TAX RELIEF	96
SALES TAX FOR STREET MAINTENANCE.....	97
SALES TAX ON RESIDENTIAL GAS AND ELECTRICITY	98
SALES TAX ON TELECOMMUNICATIONS SERVICES	99
SPECIAL IMPROVEMENT DISTRICT FUND TAX.....	101
STREET ASSESSMENTS.....	101
TIME WARRANTS	103
TRAFFIC FINE REVENUE	104
USER FEES	105
UTILITY FEES	106
VENUE TAXES.....	107

ALCOHOLIC BEVERAGE TAX

May cities tax alcoholic beverages?

Not directly. Cities must have statutory authority to levy taxes, and no such authority is provided under state law for direct taxation of alcoholic beverages (other than general application of sales taxes). Further, alcoholic beverages are highly regulated under the Texas Alcoholic Beverage Code. Any effort by a city to rely on general health and safety authority, or home rule charter authority, to directly tax alcohol would likely be preempted by state law.

Nevertheless, cities do receive a share of one of the state's taxes on alcohol, namely the mixed beverage gross receipts tax and the mixed beverage sales tax. Prior to the 2013 legislative session cities received a percentage of the statewide 14 percent tax on mixed beverage gross receipts. Legislation passed in 2013 that lowers the total mixed beverage gross receipts tax rate to 6.7 percent. The same legislation established a mixed beverage sales tax at a rate of 8.25 percent, of which cities get the same percentage as the gross receipts tax on mixed beverages. The Texas Tax Code instructs the comptroller to quarterly issue a warrant drawn on general revenue to each incorporated city in which mixed beverage taxes are levied by the state. The warrant shall be in an amount not less than 10.7143 percent of the total amount of revenue from the mixed gross receipts tax and mixed beverage sales tax within the incorporated municipality.¹

What are mixed beverages, and how are they taxed by the state (and thus a portion passed on to cities)?

The Alcoholic Beverage Code defines "mixed beverages" as follows:

"Mixed beverage" means one or more servings of a beverage composed in whole or in part of an alcoholic beverage in a sealed or unsealed container of any legal size for consumption on the premises where served or sold by the holder of a mixed beverage permit, the holder of a daily temporary mixed beverage permit, the holder of a caterer's permit, the holder of a mixed beverage later hours permit, the holder of a private club registration permit, or the holder of a private club late hours permit."²

The key phrase in the definition above is "for consumption on the premises where served or sold..." Thus, the two mixed beverage taxes tend to apply only to alcoholic drinks served at bars and restaurants, and not to alcohol sold at stores.

Such mixed beverages (as well as ice and set-ups) are taxed by the state at a rate of 6.7 percent of gross receipts by the holder of the alcohol permit.³ The city receives "no less" than a 10.7143

¹ TEX. TAX CODE § 183.051(b).

² TEX. ALCO. BEV. CODE § 1.04.

³ TEX. TAX CODE § 183.021.

percent share of the 6.7 percent state tax.⁴ That works out to roughly .072 percent of the total price.

In addition, a tax rate of 8.25 percent is imposed on each mixed beverage sold, prepared, or served by a permittee, including ice and set-ups.⁵ Instead of the holder of the permit paying the tax, like with the mixed beverage gross receipts tax, the customer pays the mixed beverage sales tax. Also like with the mixed beverage gross receipts tax, the city receives no less than a 10.7143 share of the 8.25 percent tax.⁶ That works out to roughly .088 of the total price.

Counties receive a similar portion as cities, and the remainder of the revenue from the two mixed beverage taxes goes to the state's general fund.

Does a city need to do anything to receive its share of the state's alcoholic beverage taxes?

No, the city's share is sent automatically by the comptroller. No ordinance or other action is required of the city.

Like sales taxes, there always exists the potential for misallocation of the city share of taxes due to improper records stemming from permit errors or city boundary confusion. Cities that believe they may not be receiving their proper share of the mixed beverage taxes should contact the mixed beverage division at the comptroller's office at 1-800-252-5555.

How much revenue does the city's share of the state alcoholic beverage tax generate for Texas cities?

In 2018, cities received \$106.7 million in the aggregate.⁷

For state fiscal years 2012-2103, the legislature appropriated less than the now required 10.7143 percent share of the mixed beverage gross receipts tax to Texas cities. Facing a massive budget shortfall, the legislature passed an appropriations bill that reduced the city's share of the tax to 8.3065 percent, with the difference going to the state general revenue fund.⁸ Legislation was subsequently passed that amended Texas Tax Code Section 183.021 to provide that cities can receive "no less than a 10.7143 percent share" of the mixed beverage gross receipts tax, as opposed to the previous language providing that cities could receive "no greater than a 10.7143 percent share" of the tax.⁹

As mentioned above, legislation passed in 2013 that reduces the overall rate of the mixed beverage gross receipts tax from 14 percent to 6.7 percent. Cities will still receive a 10.7143

⁴ TEX. TAX CODE § 183.051(b).

⁵ TEX. TAX CODE § 183.041.

⁶ TEX. TAX CODE § 183.051(b).

⁷ mycpa.cpa.state.tx.us/allocation/StatewideAllocMixBevResults.

⁸ http://www.lbb.state.tx.us/Documents/GAA/General_Appropriations_Act_2012-13.pdf.

⁹ Senate Bill 1, 82nd Legislature, First Special Session (2011).

percent share of the lower mixed beverage gross receipts tax, in addition to a 10.7143 percent share of the new 8.25 percent mixed beverage sales tax.

ANTICIPATION NOTES

What are anticipation notes?

An anticipation note is a debt instrument that a city may sell to finance the construction of public works; the purchase of supplies, land, and rights-of-way for public works; to pay professional services; to pay operating expenses; or to pay off cash flow deficits.¹⁰

What revenue sources may a city pledge to pay anticipation notes?

Anticipation notes can be paid from and secured by taxes, revenues (as from a utility), a combination of taxes and revenues, or the proceeds of bonds to be issued by the city.¹¹

By what method may the city council issue anticipation notes?

The city council must adopt an ordinance to authorize the issuance of anticipation notes.¹²

Are anticipation notes subject to attorney general approval?

Yes. All public securities, unless specifically excepted, must receive attorney general approval.¹³

What's the advantage of anticipation notes over bonds?

Unlike bonds, nothing in Chapter 1431 of the Texas Government Code, which authorizes anticipation notes, requires an election of the citizens to issue anticipation notes.

What's a disadvantage of anticipation notes relative to bonds?

Anticipation notes used to pay for public works or professional services must mature before the seventh anniversary after the notes are approved by the attorney general.¹⁴ Anticipation notes

¹⁰ TEX. GOV'T CODE § 1431.004(a).

¹¹ TEX. GOV'T CODE § 1431.007.

¹² TEX. GOV'T CODE § 1431.002(b).

¹³ TEX. GOV'T CODE § 1202.003.

¹⁴ TEX. GOV'T CODE § 1431.009(a).

used to pay operating expenses or to fund a city's cumulative cash flow deficit must mature before the first anniversary after the notes are approved by the attorney general.¹⁵ Bonds, on the other hand, are permitted to take decades to mature in many cases.

Also, the relative informality and lack of some safeguards that anticipation notes possess mean that a city will likely pay a higher interest rate for anticipation notes than it would for traditional bonds.

How does a city sell its anticipation notes, thus raising the needed funds?

Anticipation notes are sold by the city council at a public or private sale for cash.¹⁶

ASSESSMENTS

What are assessments?

Assessments, also known as special assessments, are fees levied against property owners who will benefit from assessment-financed improvements within public improvement districts (PIDs). Assessments are a method to charge the costs of certain city improvements, typically infrastructure, to the beneficiaries of the improvement, as opposed to the citizens at large.

For example, new sidewalks may be desired by a particular neighborhood. The city may have some revenue to improve sidewalks, but not enough to build them for every neighborhood within the city. Using general revenue tax dollars to benefit only a select few citizens is politically untenable. However, if a portion of the costs of the sidewalk could be shifted to those citizens who are asking for the improvements, everyone would be happy. Assessments are the proper tool in such situations.

While assessments within PIDs can be used to improve streets, there exists separate authority for street assessments under the Texas Transportation Code. See Chapter: *Street Assessments*.

How are assessments levied?

Generally speaking, assessments are initiated by the property owners wishing to benefit from the improvements, and cannot be forced upon the property owners by the city. The necessary steps for levying assessments are as follows:

- (1) **Petition.** Before an assessment can be levied, the city must receive a petition signed by at least: (a) owners of taxable property representing more than 50 percent of

¹⁵ TEX. GOV'T CODE § 1431.009(c).

¹⁶ TEX. GOV'T CODE § 1431.010.

the appraised value liable for assessment (that is, within the proposed PID); and (b) record owners of real property within the proposed PID that constitute more than 50 percent of all such record owners, or record owners that own taxable property constituting more than 50 percent of the total area within the PID.¹⁷

Because of the complexity of the petition requirements, a city should consult with local counsel prior to determining whether a particular petition is sufficient to allow an assessment.

(2) Findings. Once a valid petition is filed, the city council may make initial findings by resolution as to the advisability of the PID, its cost, the method of assessment, and the apportionment of cost between the proposed improvement district and the city as a whole.¹⁸

(3) Feasibility Report. A city may, but is not required to, prepare a feasibility report (a study, essentially) to determine whether improvements should be made as proposed by the petition, as well as to determine the cost.¹⁹

(4) Advisory Body. After receipt of the petition, a city council may, but is not required to, appoint an advisory body with responsibility for recommending an improvement plan to the city council. The advisory body must include: (a) owners of taxable real property representing more than 50 percent of the appraised value of the land subject to the proposed assessment; and (b) at least 50 percent of the record owners and owners of taxable real property who will be subject to the proposed assessment.²⁰ The advisory body, or other entity in its absence, is responsible for preparing a minimum five-year service plan upon creation of the district.²¹

(5) Hearing on Creation of District. The city council must hold a public hearing prior to establishing a public improvement district and levying assessments.²² A detailed newspaper notice of the hearing must occur at least 15 days prior to the hearing in a newspaper of general circulation in the city or county.²³ If any part of the district is to be located in the extraterritorial jurisdiction (ETJ) of the city, the notice must also be published in a newspaper of general circulation in the ETJ.²⁴ In addition to newspaper notice, written notice must be mailed at least 15 days prior to the hearing to each property owner who will be subject to assessments.²⁵

(6) Improvement Order. During the six-month period after the hearing is finally concluded, the city council may create the improvement district by resolution, known as

¹⁷ TEX. LOC. GOV'T CODE § 372.005(b).

¹⁸ TEX. LOC. GOV'T CODE § 372.006.

¹⁹ TEX. LOC. GOV'T CODE § 372.007.

²⁰ TEX. LOC. GOV'T CODE § 372.008.

²¹ TEX. LOC. GOV'T CODE § 372.013.

²² TEX. LOC. GOV'T CODE § 372.009(a).

²³ TEX. LOC. GOV'T CODE § 372.009(c).

²⁴ TEX. LOC. GOV'T CODE § 372.009(c).

²⁵ TEX. LOC. GOV'T CODE § 372.009(d).

an “improvement order.”²⁶ The improvement order authorizing the district must be published in the newspaper one time.²⁷ Construction of an improvement may not begin until after the 20th day following the newspaper publication of the authorization in number 5 above.²⁸ Also, construction of improvements can be stopped if two-thirds of the property owners in the district file written protests with the city during the 20 days after publication of the authorization.²⁹

(7) Preliminary Assessment Determination. The city council next determines how property within the district shall be assessed with the costs of the improvements in the district.³⁰ The apportionment of the assessments must bear a relationship to how each property is benefited by the improvements. Ideally, this calculation of assessment is being considered at each of the prior stages.

The statute provides numerous methodologies for apportioning the costs by assessment: equally by frontage or square foot; according to the value of the property; or in any other manner that results in imposing equal shares on properties similarly benefited.³¹ The amount of assessment may be adjusted following an annual review of the service plan.³²

(8) Assessment Roll. After the total cost and methodology of assessments are determined by the city council, the city council prepares an assessment roll that states the amount of the assessment against each parcel of land in the district.³³ The roll must be filed with the city secretary, and is an open record.³⁴

(9) Hearing on Assessment Roll. After the council files the assessment roll with the city secretary, a public hearing on the proposed assessments must be held.³⁵ Newspaper notice of the hearing must be published at least 10 days prior to the hearing.³⁶ The city secretary must also mail notice of the assessment hearing to each affected property owner.³⁷ At the hearing, each and every objection lodged against the assessment must be voted on by the council.³⁸

(10) Levy of Assessment. After all objections have been voted on by the council, the assessment is finally levied by ordinance or order of council.³⁹ The ordinance or order must specify the method of payment, which can include periodic installments.⁴⁰

²⁶ TEX. LOC. GOV'T CODE § 372.010(a).

²⁷ TEX. LOC. GOV'T CODE § 372.010(b).

²⁸ TEX. LOC. GOV'T CODE § 372.010(c).

²⁹ TEX. LOC. GOV'T CODE § 372.010(c).

³⁰ TEX. LOC. GOV'T CODE § 372.015.

³¹ TEX. LOC. GOV'T CODE § 372.015(b).

³² TEX. LOC. GOV'T CODE § 372.015(d).

³³ TEX. LOC. GOV'T CODE § 372.016(a).

³⁴ TEX. LOC. GOV'T CODE § 372.016(b).

³⁵ TEX. LOC. GOV'T CODE § 372.016(b).

³⁶ TEX. LOC. GOV'T CODE § 372.016(b).

³⁷ TEX. LOC. GOV'T CODE § 372.016(c).

³⁸ TEX. LOC. GOV'T CODE § 372.017(a).

³⁹ TEX. LOC. GOV'T CODE § 372.017(b).

⁴⁰ TEX. LOC. GOV'T CODE § 372.017(b).

What projects may be funded by assessments within PIDs?

The statute lists a broad variety of projects that may be funded by assessments: landscaping; fountains; lighting; signs; street and road acquisition, construction, and repair; sidewalks; right-of-way acquisition; pedestrian malls; art; libraries; parking facilities; mass transportation facilities; water and wastewater facilities; drainage facilities; parks; other similar projects; and the “development, rehabilitation, or expansion of affordable housing.”⁴¹

The statute also recognizes the acquisition of real property in connection with an improvement, special supplemental services for improvement and promotion of the district, and the payment of expenses incurred in establishing and operating the district as authorized projects.⁴²

What happens if a property owner fails to pay an assessment?

If a property owner fails to pay an assessment, the assessment constitutes a lien against the property and is a personal debt of the property owner.⁴³ The lien is superior to all other liens except for non-payment of property taxes.⁴⁴ While the statute provides that an assessment lien may be enforced by the city council in the same manner than a property tax lien may be enforced, the attorney general has opined that a homestead may not be subjected to forced sale for nonpayment of a PID assessment.⁴⁵

How may an improvement district, and its accompanying assessments, be dissolved?

To dissolve a district, the city must receive a petition signed by at least the same number of property owners in the district that were necessary to create the district in the first place.⁴⁶ After receipt of the petition, the city council calls a hearing.⁴⁷ At the conclusion of the hearing, the statute does not state exactly how the district is dissolved, but it is presumably done by resolution of the city council.

Are there other methods besides assessments to fund PIDs?

Yes, a city council may levy an annual tax to support the administrative and planning elements of a PID.⁴⁸ No procedures are specified in the chapter for levying this tax.

⁴¹ TEX. LOC. GOV'T CODE § 372.003.

⁴² TEX. LOC. GOV'T CODE § 372.003.

⁴³ TEX. LOC. GOV'T CODE § 372.018(b)(3).

⁴⁴ TEX. LOC. GOV'T CODE § 372.018(b)(2).

⁴⁵ TEX. LOC. GOV'T CODE § 372.018(e); Tex. Att'y Gen. Op. No. JC-0386 (2001).

⁴⁶ TEX. LOC. GOV'T CODE § 372.011.

⁴⁷ TEX. LOC. GOV'T CODE § 372.011.

⁴⁸ TEX. LOC. GOV'T CODE § 372.021.

What is a tourism public improvement district?

A tourism public improvement district (PID) is designed to encompass one or more hotels and collect an assessment from hotels in the district to be used for advertising, promotion, and business recruitment directly related to hotels.⁴⁹ The concept of a tourism PID was first introduced in Texas in 2011 when legislation passed authorizing a tourism PID only in the City of Dallas. Legislation passed in 2019 allowing any city in Texas to create a tourism PID.⁵⁰

A tourism PID can include noncontiguous areas so long as the areas consist of one or more hotels and share a common characteristic or use.⁵¹ Further, a city council may later include additional property in a tourism PID if: (1) the property is a hotel; and (2) the property could have been included in the district without violating the petition process when the district was created regardless of whether the record owners of the property signed the original petition.

Unlike with a traditional PID, the petition for the establishment of a tourism PID is sufficient only if signed by record owners of taxable real property constituting: (1) more than 60 percent of the appraised value of taxable real property liable for assessment under the proposed tourism PID; and (2) either more than 60 percent of all record owners of taxable real property liable for assessment or more than 60 percent of the area of all taxable real property liable for assessment.⁵²

A city that creates a tourism PID may adopt procedures for the collection of assessments that are consistent with the city's procedures for the collection of a local hotel occupancy tax and pursue remedies for failure to pay an assessment that are available to the city for failure to pay a hotel occupancy tax.⁵³

BANK LOANS

May a city borrow money from a bank?

Yes, but if the loan is unsecured by taxes, it must be repaid within the current budget year. The reason for this qualification is that the Texas Constitution prohibits cities from incurring debt without simultaneously providing a tax to repay the debt and creating an interest and sinking fund of two percent per year.⁵⁴

⁴⁹ TEX. LOC. GOV'T CODE § 372.0035.

⁵⁰ House Bill 1136, 86th Legislature, Regular Session (2019).

⁵¹ TEX. LOC. GOV'T CODE §§ 372.0035(b) and (c).

⁵² TEX. LOC. GOV'T CODE §§ 372.005(b-1).

⁵³ TEX. LOC. GOV'T CODE §§ 372.0035(d).

⁵⁴ TEX. CONST. art. 11, §§ 5 and 7.

Could a city take out a long-term bank loan, provided it pledges a tax and creates a sinking fund to repay the loan?

This has never been directly addressed by the courts with respect to cities. In 1999, the attorney general addressed the question of whether a county could borrow money by purporting to pledge its taxes to payment of interest and the establishment of a sinking fund, while avoiding the statutorily-authorized mechanisms of bonds, certificates of obligation, or other debt obligations.⁵⁵ The opinion concluded that the county could not because it lacked statutory authority to levy taxes to secure a loan in the same way that it has authority to levy taxes to secure bonds, anticipation notes, and certificates of obligation. The authority to levy and pledge taxes for interest and sinking fund purposes is not implied by the Article 11, Sections 5 and 7 of the Texas Constitution, but must be found elsewhere in the statutes.⁵⁶ According to the attorney general, simply pledging future tax revenue to pay a long-term loan would circumvent the safeguards, such as attorney general approval, that are required of bonds and other debt instruments.

While the attorney general's reasoning would seem applicable to cities, the situation is clouded by a section of the Local Government Code that authorizes general law cities to "borrow money based on the credit of the municipality" for certain purposes such as streets, hospitals, and other facilities.⁵⁷ An argument could be made that this section constitutes statutory authority for cities to obtain bank loans, though it is unclear how the statute accounts for the limitations on debt in the Texas Constitution because the statute does not clearly authorize a city to levy a tax to pay down the debt.

It also could be suggested that the loan agreement with the bank contains a clause that the city's obligation to pay back the bank will be satisfied out of current revenues each year, similar to a clause authorized by Local Government Code Section 271.903 for the acquisition of real or personal property. As a practical matter, however, banks are unlikely to sign an agreement that would allow the city council to stop paying back the loan in a future year.

The safest interpretation of the relevant law is that a city can likely only take out a bank loan if the loan is repaid within the current budget year. A city wishing to take out a long-term bank loan should do so only in reliance upon an opinion by its city attorney or bond counsel.

BINGO PRIZE FEES

What are bingo prize fees?

⁵⁵ Op. Tex. Att'y Gen. No. JC-0139 (1999).

⁵⁶ *Mitchell County v. City Nat. Bank*, 43 S.W. 880 (1898).

⁵⁷ TEX. LOC. GOV'T CODE § 101.005(c).

Cities were once permitted to levy a gross receipts tax on charitable bingo operations within the city. Though that authority has long since been cancelled, cities that had a bingo tax in place as of January 1, 1993, were permitted to a 50-percent share of the five-percent prize fee that the licensed bingo organization must collect and remit to the state. If both a city and county were entitled to a share of the prize fee, each received 25 percent of the fee.

Legislation passed in 2019 reconfigures how cities and counties receive bingo prize fee revenue.⁵⁸ An authorized organization that holds a license to conduct bingo is required to collect from a person who wins a cash bingo prize of more than \$5, a five-percent fee on the amount of the prize.⁵⁹ The organization then must remit 50 percent of the fee revenue to the Texas Lottery Commission, and the other 50 percent to the city and/or county in which the bingo game is conducted, if: (1) the city or county was entitled to receive a portion of a bingo prize fee as of January 1, 2019; and (2) the governing body of the city or county voted before November 1, 2019 to impose the new prize fee.⁶⁰ In other words, only cities that were previously authorized to collect a prize fee under the old law because they had a bingo tax in place as of January 1, 1993 can collect the new prize fee, and even then only if the city council took action before November 1, 2019 to essentially reauthorize the prize fee. A city council that takes action to impose a prize fee may at any time vote to discontinue the imposition of the fee.⁶¹

Cities with questions about their entitlement to bingo prize fees should call the Charitable Bingo Operations Division of the Lottery Commission at 1-800-246-4677.

How much bingo prize fee revenue is distributed to local governments?

Cities and counties combined will receive an estimated \$14.5 million per year through 2021.⁶²

BONDS

What are bonds?

Bonds are certificates of debt on which the city promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. Texas cities rely on bonds to borrow money to build large-scale capital improvements.

⁵⁸ House Bill 914, 86th Legislature, Regular Session (2019).

⁵⁹ TEX. OCC. CODE § 2001.502(a).

⁶⁰ TEX. OCC. CODE § 2001.502(b).

⁶¹ TEX. OCC. CODE § 2001.502(c).

⁶² State budget, Section VII-10:

http://www.lbb.state.tx.us/Documents/Appropriations_Bills/86/Conference_Bills/86R_HB1-F.pdf.

What are the different types of bonds that cities can issue?

There are three main types of bonds issued by cities: general obligation bonds, revenue bonds, and refunding bonds. General obligation bonds are secured by a pledge of city property taxes, essentially obligating a city to levy a property tax each year sufficient to pay off the bond. A revenue bond is secured by a pledge of revenue from an income-producing facility. Revenue bonds are usually designated with the name of the system that pledged the revenues (for example, Waterworks System Revenue Bonds, Waterworks and Sewer System Revenue Bonds, and so on). Finally, refunding bonds are bonds that replace or pay off outstanding bonds that the holder surrenders in exchange for the new security.

Where do Texas cities get authority to issue property tax (general obligation) bonds?

Cities derive their authority to issue bonds from Article 11, Sections 5 and 7 of the Texas Constitution, which read as follows:

Section 5 - CITIES OF MORE THAN 5,000 POPULATION; ADOPTION OR AMENDMENT OF CHARTERS; TAXES; DEBT RESTRICTIONS

(a) Cities having more than five thousand (5000) inhabitants may, by a majority vote of the qualified voters of said city, at an election held for that purpose, adopt or amend their charters. If the number of inhabitants of cities that have adopted or amended their charters under this section is reduced to five thousand (5000) or fewer, the cities still may amend their charters by a majority vote of the qualified voters of said city at an election held for that purpose. The adoption or amendment of charters is subject to such limitations as may be prescribed by the Legislature, and no charter or any ordinance passed under said charter shall contain any provision inconsistent with the Constitution of the State, or of the general laws enacted by the Legislature of this State. Said cities may levy, assess and collect such taxes as may be authorized by law or by their charters; but no tax for any purpose shall ever be lawful for any one year, which shall exceed two and one-half per cent. of the taxable property of such city, **and no debt shall ever be created by any city, unless at the same time provision be made to assess and collect annually a sufficient sum to pay the interest thereon and creating a sinking fund of at least two per cent. thereon**, except as provided by Subsection (b). Furthermore, no city charter shall be altered, amended or repealed oftener than every two years.

(b) To increase efficiency and effectiveness to the greatest extent possible, the legislature may by general law authorize cities to enter into interlocal contracts with other cities or counties without meeting the assessment and sinking fund requirements under Subsection (a).

**Section 7 - COUNTIES AND CITIES ON GULF OF MEXICO; TAX FOR
SEA WALLS, BREAKWATERS, AND SANITATION; BONDS;
CONDEMNATION OF RIGHT OF WAY**

(a) All counties and cities bordering on the coast of the Gulf of Mexico are hereby authorized upon a vote of the majority of the qualified voters voting thereon at an election called for such purpose to levy and collect such tax for construction of sea walls, breakwaters, or sanitary purposes, as may now or may hereafter be authorized by law, and may create a debt for such works and issue bonds in evidence thereof. **But no debt for any purpose shall ever be incurred in any manner by any city or county unless provision is made, at the time of creating the same, for levying and collecting a sufficient tax to pay the interest thereon and provide at least two per cent (2%) as a sinking fund,** except as provided by Subsection (b); and the condemnation of the right of way for the erection of such works shall be fully provided for.

(b) To increase efficiency and effectiveness to the greatest extent possible, the legislature may by general law authorize cities or counties to enter into interlocal contracts with other cities or counties without meeting the tax and sinking fund requirements under Subsection (a).

Section 5 only applies to home rule cities, while Section 7 applies to all cities, including general law cities.

While the above constitutional provisions do not explicitly say that cities may issue bonded debt, they serve that purpose in a round-about way by saying that debt is illegal without a particularized pledge of taxes and an interest and sinking fund.⁶³

In addition to the Texas Constitution's provisions, there exist numerous state statutes authorizing the issuance of tax bonds. One of the most general and widely applicable is in Chapter 1331 of the Texas Government Code:

§ 1331.001. AUTHORITY OF MUNICIPALITY TO ISSUE BONDS. A municipality may issue bonds payable from ad valorem taxes in the amount it considers expedient to:

- (1) construct or purchase permanent improvements inside the municipal boundaries, including public buildings, waterworks, or sewers;
- (2) construct or improve the streets and bridges of the municipality; or

⁶³ See *McNeill v. City of Waco*, 33 S.W. 322 (1895); *Basset v. City of El Paso*, 30 S.W. 893 (1895).

- (3) construct or purchase building sites or buildings for the public schools and other institutions of learning inside the municipality, if the municipality has assumed exclusive control of those schools and institutions.

Numerous other state statutes speak to city authority to issue bonds.

Must voters approve bonds?

All general obligation bonds—that is, bonds paid from property taxes—must first be approved by the qualified voters of the city at an election.⁶⁴

Revenue bonds that are not payable from any taxes need not be submitted to the voters for approval under state law.⁶⁵ Some home rule charters do require an election, however.

Following a required election, if any, does a city need approval from anyone to issue bonds?

Yes. All proposed bonds must be submitted to, and approved by, the Texas Attorney General.⁶⁶

Does the attorney general charge a city for review of a bond issue?

Yes. A city must pay a statutorily-authorized fee equal to the lesser of one-tenth of the principal amount of the bond issue or \$9,500, but in no event less than \$750.⁶⁷

Other than the fact that it's legally required, are there any advantages to having attorney general approval of bonds?

According to state statute, once bonds are approved by the attorney general they are “valid and incontestable in a court or other forum and are binding obligations for all purposes according to their terms”.⁶⁸ In other words, the legal validity of the bond cannot easily be challenged by third parties once the attorney general’s office has given its approval.

Are revenue bonds a constitutional debt requiring an interest and sinking fund?

⁶⁴ TEX. GOV'T CODE §1251.001.

⁶⁵ *Atkinson v. City of Dallas*, 353 S.W.2d 275 (Tex.Civ.App.--Dallas 1961, writ ref'd n.r.e.).

⁶⁶ TEX. GOV'T CODE §1202.003.

⁶⁷ TEX. GOV'T CODE §1202.004.

⁶⁸ TEX. GOV'T CODE §1202.006.

No, revenue bonds are not considered debts under the Texas Constitution.⁶⁹

What is the procedure for issuing bonds?

The issuance of tax bonds is a fairly involved process, best accomplished by professionals such as bond counsel and special financial advisors. A city should consult with its city attorney about locating proper bond counsel for a particular project.

CEMETERY TAX

Are there any revenue sources available to fund operations of cemeteries by the city?

Yes, a little-known provision in the Texas statutes permits a city that serves as a trustee for a cemetery, inside or outside of city limits, to levy up to a five-cent (per \$100) property tax within the city to fund the cemetery operations.⁷⁰

How is a cemetery tax levied?

The state statute is silent on the procedures for levying a cemetery tax. Because a city could simply increase its general revenue property tax by any amount to pay for cemetery costs, a court would likely find that the cemetery property tax was intended by the legislature to be a stand-alone property tax, levied separately (though perhaps at the same time) from the general revenue property tax. Likewise, the cemetery property tax would presumably operate outside the city's usual no-new-revenue and voter-approval property tax rate calculations; otherwise, it would have no independent significance. Nothing in the statute would prohibit the appraisal district and tax collector from administering the tax, however.

A city desiring to levy a cemetery property tax should consult with its city attorney about drafting a proper ordinance.

CERTIFICATES OF OBLIGATION

What is a certificate of obligation?

⁶⁹ *Atkinson v. City of Dallas*, 353 S.W.2d 275 (Tex.Civ.App.--Dallas 1961, writ ref'd n.r.e.).

⁷⁰ TEX. HEALTH & SAFETY CODE §§ 713.002 and 713.006.

A certificate of obligation (CO) is a debt instrument that can be issued by a city to: (1) pay for the construction of a public work; (2) purchase materials, supplies, equipment, machinery, buildings, land, and right-of-way for authorized needs and purposes; and (3) pay contractual obligations for professional services.⁷¹ COs function similarly to bonds, but with fewer procedural requirements.

What can a city pledge to pay off COs?

Like a bond, a CO can be paid through taxes, revenues (as from a utility), or a combination of the two.⁷²

What types of cities may issue COs?

Any Texas city, except for a Type B general law city or a Type C general law city with a population of 201 to 500 inhabitants, may issue COs.⁷³

What is the main difference between COs and general obligation (tax) bonds?

Unlike general obligation bonds, COs don't require up-front voter approval. Only if the city receives a petition protesting the issuance of the CO that is signed by five percent of the city's qualified voters must an election be held.⁷⁴

A petition triggering a CO election must be received by the city prior to the date tentatively set for the order or ordinance that authorizes the issuance of the CO (at least 45 days must pass after the first publication of notice of intent to issue COs and adoption of the order or ordinance).⁷⁵ If a petition is received, an election must be held, and is to be conducted in the same manner as a bond election.

If COs don't normally require an election, why issue bonds?

Because of their perceived safety and formality, it is commonly thought that bonds afford the city a lower interest rate, yet this is seldom true in practice. A legal pledge of property taxes is technically just as "safe" for a CO as it is for a bond issue, so interest rates are more or less the same. Bonds continue to be popular simply because certain projects lend themselves to an election to gauge public support. Any general obligation debt instrument triggers a higher

⁷¹ TEX. LOC. GOV'T CODE § 271.045.

⁷² TEX. LOC. GOV'T CODE § 271.049.

⁷³ TEX. LOC. GOV'T CODE § 271.044; *See Also* TEX. LOC. GOV'T CODE § 51.051(b).

⁷⁴ TEX. LOC. GOV'T CODE § 271.049(c).

⁷⁵ The petition must contain all the usual information required of petitions by the Texas Election Code. *Baugh v. Williams*, 762 S.W.2d 627 (Tex.App.—Tyler 1988).

property tax rate to pay the debt; thus, it provides some political “cover” to have voter approval in the first place.

If city voters reject a bond issuance at an election, can a city simply finance the same project using a CO?

No. Legislation passed in 2015 provides that a city generally may not authorize a CO to pay a contractual obligation to be incurred if a bond proposition to authorize the issuance of bonds for the same purpose was submitted to the voters during the preceding three years and failed to be approved.⁷⁶ Exceptions to this general rule include situations where a city must act promptly in response to a public calamity, when it is necessary to preserve or protect the public health, in a case of unforeseen damage to public equipment or other property, and in order to comply with a state or federal law, rule, or regulation if the city has been officially notified of noncompliance.⁷⁷

How do the citizens find out about the proposed issuance of COs, thus giving them an opportunity to petition for an election?

A city must publish notices in a newspaper of general circulation in the area that the city intends to issue COs. The notice must be published once a week for two consecutive weeks, with the date of the first publication occurring before the 45th day before the date tentatively set for the passage of the ordinance authorizing the issuance of the COs.⁷⁸ If the city maintains a website, the notice must be continuously posted on the website for at least 45 days before the date set for the passage of the authorizing ordinance.⁷⁹

The notice itself must include: (1) the time and place set for the passage of the ordinance authorizing the issuance of the certificates; (2) the purpose of the certificates; (3) the manner in which the certificates will be paid for (taxes, revenues, or both); and (4) various types of information relating to the principal and interest, both in relation to the certificates to be authorized and reflecting the total amount of outstanding debt.⁸⁰

Must COs receive attorney general approval?

COs issued directly to a contractor need not receive attorney general approval.⁸¹ All other COs must receive attorney general approval.⁸²

⁷⁶ TEX. LOC. GOV'T CODE § 271.047(d).

⁷⁷ TEX. LOC. GOV'T CODE § 271.047(d).

⁷⁸ TEX. LOC. GOV'T CODE § 271.049(a).

⁷⁹ TEX. LOC. GOV'T CODE § 271.049(a).

⁸⁰ TEX. LOC. GOV'T CODE § 271.049(b)(4).

⁸¹ TEX. GOV'T CODE § 1202.007(a)(3).

⁸² TEX. GOV'T CODE § 1202.003(a).

May the charter of a home rule city prevent the issuance of COs?

No. COs are an available debt instrument even if a home rule charter provision would seem to preclude them.⁸³

May the proceeds from the sale of COs be used to pay city employee salaries?

It depends. If new city employees are hired specifically to work on the project, their salaries can be paid from the proceeds of the sale of COs. If pre-existing city employees are used to work on a project for which a CO is issued, those employees may have their salaries paid only if the city incurred equivalent or greater costs to replace the normal work that would otherwise have been performed by the employee. In other words, pre-existing employees who work on a project but are not replaced by other employees cannot have their salaries paid out of the proceeds of COs.⁸⁴

CHILD SAFETY FINES

What are child safety fines?

Cities under 850,000 population may adopt an optional municipal court fine on parking violations, if the city has a parking ordinance that provides penalties for violations. Proceeds of the fine are used for child safety.

The optional court fine can be any amount up to \$5 and is paid on conviction of a parking violation, just as with other court costs.⁸⁵ Cities with populations greater than 850,000 must levy the fine in an amount between \$2 and \$5.⁸⁶

How is the child safety fine adopted?

A city council adopts the child safety fine by “order.”⁸⁷ An order is similar to a resolution.

What can the proceeds of the fine be spent on?

Cities under 850,000 population: If the city operates a school crossing guard program, the proceeds of the fine must be spent on that program. If the city does not operate a school crossing guard program, the city may either deposit the additional money in an interest-bearing account or

⁸³ TEX. LOC. GOV'T CODE § 271.044(b).

⁸⁴ TEX. LOC. GOV'T CODE § 271.050(b).

⁸⁵ TEX. CRIM. PROC. CODE § 102.014(b).

⁸⁶ TEX. CRIM. PROC. CODE § 102.014(a).

⁸⁷ TEX. CRIM. PROC. CODE § 102.014(b).

expend it for programs designed to enhance child safety, health, or nutrition, including child abuse prevention and intervention and drug and alcohol abuse prevention.⁸⁸ A city under 850,000 population is also authorized to spend the additional money on programs designed to enhance public safety and security.⁸⁹

Cities over 850,000 population: The city must deposit the proceeds of the fine into the required municipal child safety trust fund under Chapter 106 of the Local Government Code.⁹⁰ With the exception of spending money on programs designed to enhance public safety and security, money in that fund is to be spent in a similar fashion to smaller cities above: school crossing guard programs, or other child safety and health initiatives.⁹¹

In addition to the optional parking violation fine, are there other fines that must be spent on child safety?

Yes, school crossing zone violations and violations for improperly passing a stopped school bus trigger an automatic \$25 fine that must be spent in the same manner as the optional parking violation court cost.⁹²

COIN-OPERATED MACHINE TAX

What is a coin-operated machine tax?

A city is authorized to impose an “occupation tax” on coin-operated machines used within the city.⁹³

How are coin-operated machines defined for purposes of the tax?

A coin-operated machine “means any kind of machine or device operated by or with a coin or other United States currency, metal slug, token, electronic card, or check, including a music or skill or pleasure coin-operated machine.”⁹⁴

How much may the city levy in coin-operated machine taxes?

⁸⁸ TEX. CRIM. PROC. CODE § 102.014(g).

⁸⁹ TEX. CRIM. PROC. CODE § 102.014(g).

⁹⁰ TEX. CRIM. PROC. CODE § 102.014(f).

⁹¹ TEX. LOC. GOV'T CODE § 106.003.

⁹² TEX. CRIM. PROC. CODE § 102.014(c).

⁹³ TEX. OCC. CODE § 2153.451(a).

⁹⁴ TEX. OCC. CODE § 2153.002(1).

The city tax may be in any amount not to exceed one-fourth of the state's own \$60 coin-operated machine tax. Thus, the city can levy up to \$15 per machine per year in taxes.⁹⁵

How does a city adopt a coin-operated machine tax?

The statute does not specify a procedure for adopting the tax. The city should consider adopting the tax by ordinance and adopting reasonable enforcement procedures.

CREDIT CARD REIMBURSEMENT FEES

If a city accepts payment for services or fines by credit card, may the city charge a fee to offset the transactional costs of making credit card payment available?

Yes. The city council may authorize a municipal official who collects fees, fines, court costs, or other charges to collect a reimbursement fee for processing the payment by credit card.⁹⁶

How is a credit card reimbursement fee adopted?

The amount of the fee is set by city council.⁹⁷ The council should adopt an ordinance or resolution setting the fee.

How much of a credit card reimbursement fee can be charged?

The reimbursement fee adopted by the city council must be in an amount that is reasonably related to the expense incurred by the municipal official in processing the payment by credit card. The fee cannot exceed five percent of the amount of the fee, fine, court cost, or other charge being paid by credit card.⁹⁸

DONATIONS

May a city accept a donation of property, including money, from an individual or other private entity?

⁹⁵ TEX. OCC. CODE §§ 2153.451(b) and 2153.401(b).

⁹⁶ TEX. LOC. GOV'T CODE § 132.002(b).

⁹⁷ TEX. LOC. GOV'T CODE § 132.002(b).

⁹⁸ TEX. LOC. GOV'T CODE § 132.003(b).

Most attorneys would agree that a general law city must identify an affirmative grant of express or implied authority in order to accept a donation. City attorneys disagree, however, on whether state law gives cities broad authority to accept gifts or donations. Some city attorneys cite a state statute that provides that a city “may take, hold, purchase, lease, grant, or convey property located in or outside the municipality” as the general authority needed for a general law city to accept a donation.⁹⁹ Others point to more specific statutes authorizing the acceptance of donations by entities other than cities to demonstrate that general law cities may lack broad authority to accept donations. For instance, a county commissioners court has the statutory authority to “accept a gift, grant, donation, bequest, or devise of money or other property on behalf of the county for the purpose of performing a function conferred by law on the county or a county officer.”¹⁰⁰

Cities are, without question, expressly authorized to receive donations in certain limited circumstances. For instance, a city may accept a gift of land, money, or personal property to use in support of public recreation facilities and programs.¹⁰¹ Cities may also acquire by gift any object or collection of historic significance to the city.¹⁰² In addition, a city with a population of one million or more may solicit grants and donations for the development of an arts and entertainment district.¹⁰³ The attorney general has issued an opinion indicating that if the legislature allows an entity to receive donations in certain limited instances only, then it did not intend to grant such authority generally.¹⁰⁴ This line of reasoning, combined with the concern over whether a broad grant of authority exists, leads some city attorneys to believe that a general law city may have limited authority to accept a gift or donation.

A home rule city has the general power to hold property that it receives by gift, deed, devise, or other manner.¹⁰⁵ But because a home rule city need not look to acts of the legislature for specific authority, but instead can do what is not specifically prohibited by state law¹⁰⁶, a home rule city generally possesses the authority to accept gifts and donations. A home rule city that accepts donations should rely on language contained in the city charter that authorizes it to do so.¹⁰⁷

Cities should consult with their city attorneys and tax advisors prior to considering accepting a gift or a donation.

If a citizen is considering donating property to a city, will the donation be tax-deductible for the citizen?

⁹⁹ TEX. LOC. GOV'T CODE § 51.015(a).

¹⁰⁰ TEX. LOC. GOV'T CODE § 81.032.

¹⁰¹ TEX. LOC. GOV'T CODE §§ 273.001 and 332.006.

¹⁰² TEX. LOC. GOV'T CODE § 331.002.

¹⁰³ TEX. LOC. GOV'T CODE § 309.001.

¹⁰⁴ Op. Tex. Att'y Gen. No. GA-0562 (2007); *see also State v. Mauritz-Wells Co.*, 175 S.W.2d 238, 241 (Tex. 1943).

¹⁰⁵ TEX. LOC. GOV'T CODE § 51.0076(a).

¹⁰⁶ *Forwood v. City of Taylor*, 214 S.W.2d 282 (1948).

¹⁰⁷ *See, e.g., Whitley v. City of San Angelo*, 292 S.W.2d 857, 861 (Tex. Civ. App.—Austin 1956, no writ) (“Sec. 9 of the Charter of the City provides that it is authorized to acquire any character of property by gift.”).

Maybe. A city is a “qualified entity” to which tax-deductible charitable donations may be made.¹⁰⁸ However, a donation is only deductible if the gift is made exclusively for public purposes. Moreover, the full value of the deduction may not be deductible. Donors should consult with their own tax professionals prior to making donations.

DRAINAGE FEES

What are drainage fees?

Cities may charge a fee to cover the cost of providing the infrastructure and facilities that permit the safe drainage of storm water, prevention of surface water stagnation, and prevention of pollution arising from nonpoint runoff. Drainage “utilities” are obviously different than most other city utilities, in that it’s more difficult to directly identify and bill individual customers based on their benefit from such infrastructure. Nevertheless, state law recognizes the importance of such utilities and permits a drainage utility to charge an accompanying fee.¹⁰⁹

When and how may a city charge a drainage fee?

Before a city may charge a drainage fee, it must comply with Subchapter C of Chapter 552 of the Texas Local Government Code, known as the “Municipal Drainage Utility Systems Act” (the “Act”). Generally speaking, the purpose of the Act is to require a city to comply with certain procedures and formalities, and to generally treat its drainage system as a formal utility service, before a fee is permitted. The entire point of the Act is the fee, and the steps that must be taken prior to levying the fee.

Most Texas cities do not attempt to charge a fee for drainage; hence, those cities need not comply with the requirements of the Act. Those cities may simply build drainage infrastructure using general fund money.

What are the procedures for establishing a drainage utility, thus permitting a drainage fee?

To establish a drainage utility, and therefore to be able to charge a fee for drainage, a city must do the following:

(1) Findings

The city council makes “findings” (ideally by resolution) that:

¹⁰⁸ 26 U.S.C. § 170(c); Dep’t of the Treasury Internal Revenue Service, Charitable Contributions: Publication 526 at 3 (2014), available at <http://www.irs.gov/publications/p526>.

¹⁰⁹ TEX. LOC. GOV’T CODE §§ 552.041 – 552.054.

- a. The city intends to establish a schedule of drainage charges against all real property in the proposed service area of the utility;¹¹⁰
- b. The city will provide drainage for all real property in the proposed service area on payment of drainage charges, except for exempt property;¹¹¹ and
- c. The city will offer drainage service on nondiscriminatory, reasonable, and equitable terms.¹¹²

(2) Published Notice of Ordinance

At least 30 days prior, the city must publish in the newspaper the first notice of a public hearing to consider the adoption of a drainage system ordinance. After the first published notice, the city must publish two additional newspaper notices prior to the hearing, but not necessarily 30 days before, as with the first notice. The published notices must contain the time and place of the hearing, and must contain the complete text of the ordinance to be adopted.¹¹³

(3) Public Hearing on Drainage Ordinance

The city must hold a public hearing to take public testimony on the proposed drainage system ordinance.¹¹⁴

(4) Adopt Drainage Ordinance

Sometime after the conclusion of the public hearing (it can be at the same meeting), the city council adopts an ordinance that:

- a. States something to the effect of: “The City of _____ hereby Adopts Subchapter C, Section 552.043 of the Texas Local Government Code (the Municipal Drainage Utility System Act)¹¹⁵; and
- b. States that “The drainage system of the City of _____ is hereby declared to be a public utility.”¹¹⁶

(5) Draft Proposed Schedule of Charges

After adoption of the ordinance above, the city should prepare a proposed, or draft, “schedule” of drainage charges, consistent with the charge methodology in the question below (How is a drainage fee calculated?).¹¹⁷

¹¹⁰ TEX. LOC. GOV’T CODE § 552.045(b)(1).

¹¹¹ TEX. LOC. GOV’T CODE § 552.045(b)(2).

¹¹² TEX. LOC. GOV’T CODE § 552.045(b)(3).

¹¹³ TEX. LOC. GOV’T CODE § 552.045(c).

¹¹⁴ TEX. LOC. GOV’T CODE § 552.045(c).

¹¹⁵ TEX. LOC. GOV’T CODE § 552.045(a).

¹¹⁶ TEX. LOC. GOV’T CODE § 552.045(a).

¹¹⁷ TEX. LOC. GOV’T CODE § 552.045(d).

(6) Published Notice of Drainage Charges

At least 30 days prior, the city must publish in the newspaper the first notice of a public hearing to consider the adoption of the proposed drainage charges. After the first published notice, the city must publish two additional newspaper notices prior to the hearing, but not necessarily 30 days before, as with the first notice. The published notices must contain the time and place of the hearing, and contain the complete text of the charge proposal.¹¹⁸

(7) Hearing on Drainage Charges

The city must hold a public hearing to take testimony on the proposed drainage charges.¹¹⁹

(8) Prepare an Inventory

Prior to adopting the final schedules of drainage of charges, a city must prepare an inventory of the lots and tracts within the service area, upon which the city council must base its charge calculations.¹²⁰

(9) Adopt Drainage Charge Schedule

After the public hearing, the city adopts the schedule of drainage charges. The statute does not specify in what form the schedule is to be adopted. The recommended procedure would be as a follow-up ordinance to the original ordinance establishing the drainage utility (above).

(10) Adopt Other Rules

After adoption of the two ordinances above, the city council can adopt additional rules governing the drainage utility as the council considers necessary.¹²¹

How is a drainage fee calculated?

The city council may establish a fee structure that charges individual lots or tracts of benefited property for drainage service on any basis other than the value of the property, but the basis used must directly relate to drainage and the terms of the levy.¹²² A totally uniform drainage charge imposed solely for reason of administrative convenience would likely be improper, however, so a city should establish a basis for the fee, such as impact of the lot on the system, benefits to the lot, and other criteria.¹²³

¹¹⁸ TEX. LOC. GOV'T CODE § 552.045(d).

¹¹⁹ TEX. LOC. GOV'T CODE § 552.045(d).

¹²⁰ TEX. LOC. GOV'T CODE § 552.047(b).

¹²¹ TEX. LOC. GOV'T CODE § 552.045(e).

¹²² TEX. LOC. GOV'T CODE § 552.047.

¹²³ Op. Tex. Att'y Gen. No. LO 97-095 (1975).

How do drainage fees relate to impact fees?

Impact fees are up-front fees charged to developers for the burden their new development will place on city infrastructure. Drainage fees are ongoing user fees charged to the owner of land for their use of the drainage infrastructure. Collection of drainage fees does not preclude the imposition of drainage-related impact fees.¹²⁴

What properties are exempt from drainage fees?

Land owned by the state, a county, a municipality, or a school district may be exempted from drainage charges.¹²⁵ Also exempt is property with proper construction and maintenance of a wholly sufficient and privately owned drainage system; property held and maintained in its natural state; and undeveloped subdivided lots.¹²⁶ Also, though not in Chapter 552 of the Local Government Code along with the other exemptions, state agencies and public institutions of higher education are exempted from drainage fees.¹²⁷

A city may, but is not required to, exempt property owned by a tax-exempt religious organization from all or a portion of drainage fee charges as the city council considers appropriate.¹²⁸ Additionally, a city may exempt property used for cemetery purposes from drainage fee charges if the cemetery is closed to new internments and does not accept new burials.¹²⁹

What can the city do if a person doesn't pay drainage fees?

If a user of the drainage utility does not pay drainage fees, the city can: (1) bring a civil lawsuit; (2) discontinue any other city utility service¹³⁰; or (3) prohibit usage of the drainage facility by the owner of the tract or lot (assuming this is possible).¹³¹

What may drainage fees be spent on?

Drainage fees may only be spent to offset costs of providing drainage service and, only if specifically provided for in the ordinance, to fund future drainage system construction by the city.¹³²

¹²⁴ TEX. LOC. GOV'T CODE § 552.054(3).

¹²⁵ TEX. LOC. GOV'T CODE § 552.053(b); *See also* Tex. Att'y Gen. Op. No. GA-1080 (2014).

¹²⁶ TEX. LOC. GOV'T CODE § 552.053(c).

¹²⁷ TEX. LOC. GOV'T CODE § 580.003.

¹²⁸ TEX. LOC. GOV'T CODE § 552.053(d).

¹²⁹ TEX. LOC. GOV'T CODE § 552.053(d-1).

¹³⁰ TEX. LOC. GOV'T CODE § 552.050.

¹³¹ TEX. LOC. GOV'T CODE § 552.047(d).

¹³² TEX. LOC. GOV'T CODE § 552.044(4).

How must drainage fee proceeds be handled within the city’s fund structure?

Drainage fees must initially be segregated and separately accounted for within the account structure. Thereafter, proceeds of fees to cover current costs of service may be transferred to the city’s general fund, while other proceeds, including those used to pay for future construction, must remain segregated.¹³³

FELONY FORFEITURE FUNDS

What are felony forfeiture funds?

Chapter 59 of the Code of Criminal Procedure allows for police seizure and forfeiture of property used in, and the proceeds gained from, the commission of certain crimes. After seizure, the criminal district attorney may, by agreement, distribute property and funds to local law enforcement agencies to be used for official purposes.¹³⁴ State statute provides, in pertinent part:

If a local agreement exists between the attorney representing the state and law enforcement agencies, all money, securities, negotiable instruments, stocks or bonds, or things of value, or proceeds from the sale of those items, shall be deposited...according to the terms of the agreement into one or more of the following funds...

(2) **a special fund in the municipal treasury** if distributed to a municipal law enforcement agency, to be used solely for law enforcement purposes[.]¹³⁵

“Law enforcement purposes” are defined as “an activity of a law enforcement agency that relates to the criminal and civil enforcement of the laws of this state” and specifically include:

- (1) equipment, including vehicles, computers, firearms, protective body armor, furniture, software, uniforms, and maintenance equipment;
- (2) supplies, including office supplies, mobile phone and data account fees for employees, and Internet services;
- (3) investigative and training-related travel expenses, including payment for hotel rooms, airfare, meals, rental of and fuel for a motor vehicle, and parking;
- (4) conferences and training expenses, including fees and materials;
- (5) investigative costs, including payments to informants and lab expenses;

¹³³ TEX. LOC. GOV’T CODE § 552.049.

¹³⁴ TEX. CRIM. PROC. CODE §§ 59.01 and 59.06.

¹³⁵ TEX. CRIM. PROC. CODE § 59.06(c) (emphasis added).

- (6) crime prevention and treatment programs;
- (7) facility costs, including building purchase, lease payments, remodeling and renovating, maintenance, and utilities;
- (8) witness-related costs, including travel and security; and
- (9) audit costs and fees, including audit preparation and professional fees.¹³⁶

Who decides how felony forfeiture money is spent?

The police chief has sole decision-making authority about how felony forfeiture funds are spent:

Proceeds awarded under this chapter to a law enforcement agency...may be spent **by the agency**...after a budget for the expenditure has been submitted to the...governing body of the municipality. The budget must be detailed and clearly list and define the categories of expenditures, but may not list details that would endanger the security of an investigation or prosecution.¹³⁷

Legislation passed in 2011 prohibits felony forfeiture funds from being spent in certain ways. Specifically, state law now precludes a police department from using forfeited proceeds or property to: (1) contribute to a political campaign; (2) pay expenses related to the training or education of any member of the judiciary; (3) pay travel expenses related to attendance at training seminars if the expenses violate any restrictions established by the city council; (4) purchase alcoholic beverages; or (5) increase a salary, expense, or allowance for an employee of a police department unless the city council first approves the increase.¹³⁸ Additionally, a police department is prohibited from using felony forfeiture proceeds or property to make a donation to another entity, unless the entity assists in investigating criminal offense or instances of child abuse; provides mental health, drug, or rehabilitation services or services for victims or witnesses of criminal offenses or child abuse; or provides training or education relating to these types of duties or services.¹³⁹

Where must felony forfeiture money be kept?

State law plainly provides that the forfeited funds are held in the municipal treasury.¹⁴⁰ It would therefore be improper for the police chief to hold these funds in a separate institution from the

¹³⁶ TEX. CRIM. PROC. CODE § 59.06(d-3).

¹³⁷ TEX. CRIM. PROC. CODE § 59.06(d) (emphasis added).

¹³⁸ TEX. CRIM. PROC. CODE § 59.06(d-1).

¹³⁹ TEX. CRIM. PROC. CODE §§ 59.06(d-1)(2) and (d-2).

¹⁴⁰ TEX. CRIM. PROC. CODE § 59.06(c)(2); *See also* Op. Tex. Att’y Gen. No. DM-162 (1992) (concluding that county forfeiture funds, which are procedurally similar to city funds, “will be deposited with the county treasurer for placement in the county depository in the manner in which county funds are generally handled.”); Op. Tex. Att’y Gen. No. DM-247 (1993) (separate depository for county funds not proper).

city depository. To do so would violate the plain language of the statute and threaten the protections, such as collateralization of public funds, that are required of funds in the municipal depository.

Legislation passed in 2015 providing that a city may transfer up to 10 percent of the gross amount credited to the city's felony forfeiture fund to a separate special fund established in the city's treasury to be used to provide scholarships to children of peace officers who were employed by the city police department (or another law enforcement agency with overlapping jurisdiction) that were killed in the line of duty.¹⁴¹ The city police department shall administer this separate special fund.¹⁴²

If the council can't spend the money, can it at least know how the money is spent?

Yes. The city council is entitled to receive a budget for how the funds will be spent, but generally is not authorized to approve of the actual expenditures decided upon by the police chief.¹⁴³ The one instance in which the statute requires the city council to approve the use of felony forfeiture funds is when the police chief wishes to spend the funds to increase a salary, expense, or allowance for an employee of the police department.¹⁴⁴

May the city conduct an audit of the felony forfeiture funds?

Yes. Expenditures of felony forfeiture proceeds are subject to audit provisions established in the Code of Criminal Procedure.¹⁴⁵ Those audit provisions provide as follows:

All law enforcement agencies...who receive proceeds or property under this chapter shall account for the seizure, forfeiture, receipt, and specific expenditures of all the proceeds and property in an audit, which is to be *performed annually by the commissioners court or governing body of the municipality*, as appropriate. The annual period of the audit for a law enforcement agency is the fiscal year of the appropriate county or municipality and the annual period for an attorney representing the state is the state fiscal year. The audit must be completed on a form provided by the attorney general and must include a detailed report and explanation of all expenditures, including salaries and overtime pay, officer training, investigative equipment and supplies, and other items. Certified copies of the audit shall be delivered by the law enforcement agency or attorney

¹⁴¹ TEX. CRIM. PROC. CODE § 59.06(r).

¹⁴² TEX. CRIM. PROC. CODE § 59.06(r).

¹⁴³ TEX. CRIM. PROC. CODE § 59.06(d); *See also* Tex. Att'y Gen. Op. No. DM-72 (1991) (law enforcement agency to which funds are distributed has authority to determine purposes to which forfeiture funds are applied), Tex. Att'y Gen. Op. No. DM-246 (1993) (the commissioners court has a ministerial duty to initiate the competitive bidding process upon receipt of a request from the prosecutor or law enforcement agency and may not refuse all bids received for the purpose of preventing an expenditure out of the special forfeiture fund).

¹⁴⁴ TEX. CRIM. PROC. CODE § 59.06(d-1)(7).

¹⁴⁵ TEX. CRIM. PROC. CODE § 59.06(d).

representing the state to the attorney general not later than the 30th day after the date on which the annual period that is the subject of the audit ends.¹⁴⁶

Thus, not only is the city permitted to audit the police department fund and expenditures, but it is required to do so annually. It would be improper for a police chief to refuse to submit the forfeiture account and expenditures to an annual audit.

Must the police chief be given check-writing privileges over felony forfeiture funds?

Yes. State statute provides procedures for paying funds out of city depositories. Absent a local procedure to the contrary, checks are signed by the “designated officer” of the city, typically the treasurer, after receipt of a “warrant” signed by the mayor and attested to by the city secretary.¹⁴⁷ Most cities, however, adopt alternate procedures.

With felony forfeiture funds, the answer is different. The attorney general has concluded that a sheriff did have sole check-writing authority, subject only to the statutory requirement that the agency submit a budget for that category of expenditure.¹⁴⁸ Because of the similarities between city and county forfeiture law and check-writing procedures, it is probable that this opinion is applicable to city felony forfeiture funds as well. As a result, the police chief may likely be the sole signatory on checks drawn from the forfeiture fund.

GRANTS

May a city be the recipient of grant money?

Of course. Many Texas cities rely on grant money, typically from the federal government, to build infrastructure and operate other programs.

Is grant money treated the same as other revenue for budgeting purposes, and relating to constitutional limits on expenditures that benefit private entities?

Yes, grant revenue is no different from other sources of revenue when it comes to budgeting and expenditures. Cities must strictly budget for the expenditure of all funds, with no exceptions made for grant money.¹⁴⁹ Similarly, all expenditures of grant money must serve a municipal purpose under Article 3, Section 52 of the Texas Constitution, or otherwise meet an exception to that constitutional provision, such as for economic development. Finally, the grantor of money can establish contractual conditions related to receipt and expenditure of grant money that a city

¹⁴⁶ TEX. CRIM. PROC. CODE § 59.06(g).

¹⁴⁷ TEX. LOC. GOV'T CODE § 105.074

¹⁴⁸ Op. Tex. Att’y Gen. No. DM-247 (1993).

¹⁴⁹ TEX. LOC. GOV'T CODE § 102.009(b).

must follow. In other words, a city is not entitled to grant money it receives, but must satisfy the conditions placed on it by the grantor.

What are park grants?

State park grants are one of the few areas of state revenue that flows directly to cities. As of 2019, the Texas Constitution and state statute provide that a portion of the state sales tax on sporting goods sold within city limits must be set aside for making grants to cities for use in improving local parks.¹⁵⁰

How do cities apply for park grants?

Information about how to apply for park grants is available at the following link to the Parks and Wildlife Department website: <https://tpwd.texas.gov/business/grants/recreation-grants>. Cities may download an application form from that website.

HOTEL OCCUPANCY TAXES

What are hotel occupancy taxes?

Cities may levy a tax on a person who—under a lease, concession, permit, right of access, license, contract, or agreement—pays for the use or possession or for the right to the use or possession of a room that is in a hotel, costs \$2 or more each day, and is ordinarily used for sleeping.¹⁵¹

How much hotel occupancy taxes may a city levy?

Generally speaking, a city may levy a hotel occupancy tax in any amount up to, and including, seven percent of the price paid for the room.¹⁵² Select cities are authorized to levy up to eight-and-a-half or nine percent of the price of the room, so long as a portion of the revenue generated by the increased rate goes toward certain specified projects.¹⁵³ The price of the room does not include food and drink.¹⁵⁴

¹⁵⁰ TEX. CONST. art. 8, § 7-d; TEX. PARKS & WILD. CODE § 24.002.

¹⁵¹ TEX. TAX CODE § 351.002(a).

¹⁵² TEX. TAX CODE § 351.003.

¹⁵³ TEX. TAX CODE §§ 351.003, 351.1055, 351.1065, and 351.107.

¹⁵⁴ TEX. TAX CODE § 351.002(b).

What is the definition of a hotel for purposes of hotel occupancy taxes?

A hotel is defined as a building in which members of the public obtain sleeping accommodations in return for money. It includes motels, lodging houses, inns, rooming houses, and bed and breakfasts.¹⁵⁵ It does not include, and thus no tax is due for, dormitories, hospitals, and nursing homes.¹⁵⁶ In 2015, legislation passed clarifying that the definition of “hotel” includes a residential short-term rental property for purposes of the imposition of hotel occupancy taxes.¹⁵⁷

Is the hotel occupancy tax limited to hotels within the city limits?

Ordinarily yes, except that a city with a population under 35,000 may extend the application of its hotel occupancy tax by ordinance to the extraterritorial jurisdiction (ETJ) of the city.¹⁵⁸ However, a city under 35,000 population may not apply its hotel occupancy tax in the ETJ if, as a result of the adoption of the city tax, the combined rate of state, county, and city hotel taxes would exceed fifteen percent at hotels in the ETJ.¹⁵⁹ Provided the combined tax does not exceed fifteen percent at the time the city levies its tax, the city’s tax is unaffected by future taxes levied by counties or other entities that might have the effect of imposing a combined rate in excess of fifteen percent.¹⁶⁰

A city may extend its hotel occupancy tax to the ETJ by a provision in its hotel occupancy tax ordinance specifying that the tax extends to the ETJ.

How does a city levy a hotel occupancy tax?

A hotel occupancy tax must be levied by ordinance.¹⁶¹ No election or other approval of the citizens is required. Sample hotel occupancy tax ordinances can be obtained from the TML Legal Department at (512) 231-7400 or legalinfo@tml.org.

Can a city change the rate of an already-established hotel occupancy tax, and if so, how?

Yes, a city can change the rate to any amount up to, and including, seven percent (with the exception of the few cities that can adopt a higher rate). A city would amend the portion of its hotel occupancy tax ordinance relating to rate in order to change the rate. If a city increases the rate of its hotel occupancy tax, the increased rate does not apply to the tax imposed on the use or possession, or the right to the use or possession, of a room under a contract that was executed before the date the increased rate takes effect and that provides for the payment of the tax at the

¹⁵⁵ TEX. TAX CODE § 156.001.

¹⁵⁶ TEX. TAX CODE § 156.001.

¹⁵⁷ TEX. TAX CODE § 156.001(b).

¹⁵⁸ TEX. TAX CODE § 351.0025(a).

¹⁵⁹ TEX. TAX CODE § 351.0025(b).

¹⁶⁰ Op. Tex. Att’y Gen. No. GA-408 (2006).

¹⁶¹ TEX. TAX CODE § 351.002(a).

rate in effect when the contract was executed, unless the contract is subject to change or modification by reason of the tax rate increase.¹⁶²

How may hotel occupancy tax revenues be spent by a city?

Hotel occupancy tax revenues are known as “dedicated revenues,” as distinguished from general tax revenues such as property and sales taxes. General revenues may be spent on nearly any lawful pursuit of a city. Dedicated revenues, however, may only be spent on certain, statutorily-defined purposes.

Very generally speaking, all expenditures of city hotel tax revenue must promote tourism within the city. This general rule can be further broken down into two parts (often referred to as the “two-part test”):

- (a) all expenditures must promote tourism and the convention and hotel industry; and
- (b) all expenditures must further fall into one of nine statutory categories:
 - (1) the acquisition of sites for and the construction, improvement, enlarging, equipping, repairing, operation, and maintenance of convention center facilities and visitor information centers;
 - (2) expenses associated with registration of convention delegates;
 - (3) advertising, solicitations, and promotions that attract tourists and convention delegates to the city or its vicinity;
 - (4) promotion of the arts;
 - (5) historical preservation projects;
 - (6) sporting events that promote tourism in counties of less than one million population;
 - (7) enhancing or upgrading existing sports facilities or sports fields (only in certain cities);
 - (8) transportation systems that transport tourists from hotels to the commercial center of the city, a convention center, other hotels, or tourist attractions, provided the system doesn’t serve the general public; and
 - (9) signage directing the public to sights and attractions that are visited frequently by hotel guests in the city.¹⁶³

¹⁶² TEX. TAX CODE § 351.007(a).

¹⁶³ TEX. TAX CODE § 351.101.

Further, the Tax Code has some fairly specific provisions relating to how the expenditures within the nine statutory categories should be allocated, depending on the population of the city. Generally speaking, funding of the arts is limited to no more than fifteen percent of total tax revenues, and a certain portion must be spent on promoting the city and/or on convention facilities, again depending on the size of the city.¹⁶⁴

Can a city fund a fireworks show using hotel occupancy taxes?

The prototype hotel tax controversy involves an event like a fireworks show or a parade. City officials frequently ask if they can fund a fireworks show with hotel tax money.

All expenditures must be subjected to the “two-part test” spelled out in the previous question. In the first place, a fireworks show must be shown to promote tourism and the convention and hotel industry. Put another way, does the expenditure “put heads in beds”? The answer is likely not.

Even if a fireworks show attracted overnight tourists to the city, hotel tax expenditures on such an event don’t fit neatly into one of the nine statutory categories. Some may argue that such shows “advertise” the city, but this is likely not what that category means. “Advertising the city” literally means some sort of print or other media that explicitly promotes the city. Thus, direct funding of fireworks displays and the like is usually not a proper hotel tax expenditure.

May a city delegate the expenditure of hotel taxes to another entity?

Yes. A city may delegate expenditures of hotel taxes to another entity such as a chamber of commerce or convention and visitors bureau. So long as the chamber or other entity spends the money on projects that otherwise meet the two-part test mentioned above, such entities are legal agents to spend the city’s hotel tax funds. There must be a written contract laying out the duties of the entity, and the entity must keep the hotel tax funds in an account separate from the general operating fund.¹⁶⁵

What is the relationship between city and state hotel occupancy taxes?

The state collects its own hotel occupancy tax at the rate of six percent.¹⁶⁶ The state plays no part in collecting or enforcing the city’s hotel occupancy tax, however. A city is responsible for its own levy, collection, and enforcement.

What can a city do if a hotel is delinquent or refuses to pay hotel occupancy taxes?

¹⁶⁴ TEX. TAX CODE § 351.103.

¹⁶⁵ TEX. TAX CODE § 351.101(c).

¹⁶⁶ TEX. TAX CODE § 156.052.

Cities have all of the following remedies available against hotels that don't collect the tax or are delinquent in collecting the tax: civil lawsuit, injunction against operation of the hotel until taxes are paid, a fifteen-percent civil penalty against the hotel when suit is necessary (if the tax has been delinquent for one complete municipal fiscal quarter), reasonable attorney's fees, misdemeanor prosecution against the hotel (assuming the city's ordinance provides for an offense), and audit powers.¹⁶⁷ If an audit conducted by the city shows a concurrent delinquency in state hotel occupancy taxes, the city must notify the comptroller of the delinquency, and if the state proceeds with collection and enforcement efforts, the comptroller must distribute an amount to the city to defray the costs of the audit.¹⁶⁸

Are cities required to annually report hotel occupancy tax information?

Yes. Legislation passed in 2017 that requires cities to annually report hotel occupancy tax information to the comptroller.¹⁶⁹ Not later than February 20 of each year, a city that imposes a hotel occupancy tax must submit to the comptroller: (1) the rate of the city's hotel occupancy tax and, if applicable, the rate of the city's hotel occupancy tax supporting a venue project; (2) the amount of revenue collected during the city's preceding fiscal year from the city's hotel occupancy tax and, if applicable, the city's hotel occupancy tax supporting a venue project; and (3) the amount and percentage of hotel occupancy tax revenue allocated by the city for certain categories of expenditure during the city's preceding fiscal year.¹⁷⁰ Cities must comply with the annual reporting requirements by either submitting the report to the comptroller on a form prescribed by the comptroller, or alternatively providing the comptroller a direct link to, or a clear statement describing the location of, the information required to be reported that is posted on the city's website.¹⁷¹ The reporting form and historical data can be found at: <https://comptroller.texas.gov/transparency/local/hotel-receipts>.

IMPACT FEES

What are impact fees?

The Texas impact fee statute defines an impact fee as “a charge or assessment imposed by a political subdivision against new development in order to generate revenue for funding or recouping the costs of capital improvements or facility expansions necessitated by and attributable to the new development. The term includes amortized charges, lump-sum charges, capital recovery fees, contributions in aid of construction, and any other fee that functions as described by this definition.”¹⁷²

¹⁶⁷ TEX. TAX CODE § 351.004.

¹⁶⁸ TEX. TAX CODE § 351.008.

¹⁶⁹ Senate Bill 1221, 85th Legislature, Regular Session (2017).

¹⁷⁰ TEX. TAX CODE § 351.009(a).

¹⁷¹ TEX. TAX CODE § 351.009(b).

¹⁷² TEX. LOC. GOV'T CODE § 395.001(4).

Put more simply, impact fees are a way for a city to charge developers for some of the cost that new development places on the infrastructure and resources of a city.

The state of Texas allows cities to impose impact fees pursuant to Chapter 395 of the Local Government Code. Within the code, what qualifies as an “impact fee” is defined, and specific guidelines are set forth in regard to utilizing impact fees.

What may impact fees be spent on?

To determine if an expenditure of impact fees is proper, two separate tests must be satisfied: (1) the expenditure must be for a *proper impact fee facility*; and (2) even if it is a proper impact fee facility, the expenditure must be a *permissive cost* that may be funded relative to that facility.

- (1) **Proper impact fee facilities** include: (1) water supply, treatment, and distribution facilities; (2) wastewater collection and treatment facilities; (3) storm water, drainage and flood control facilities; and (4) roadway facilities.¹⁷³
- (2) **Permissive costs** relative to a proper facility include: (1) facility expansion; (2) facility construction contract price; (3) surveying and engineering fees; (4) land acquisition costs, including land purchases, court awards and costs, attorney’s fees, and expert witness fees; (5) fees to an independent qualified engineer or financial consultant preparing or updating the capital improvements plan, provided the person is not an employee of the city; and (6) interest charges and other finance costs related to improvements or expansions identified in the capital improvements plan (but only if used for payment of principal and interest on bonds, notes, or other obligations).¹⁷⁴

What items may not be paid for by an impact fee?

The Local Government Code also states that certain items may not be paid for by impact fees: (1) construction, acquisition, or expansion of public facilities or assets not identified in the capital improvements plan; (2) repair, operation, or maintenance of existing or new capital improvements or facility expansions; (3) upgrading, updating, expanding, or replacing existing capital improvements to provide better service to existing development; (4) administrative and operating costs of the city; and (5) principal payments of interest or other finance charges on bonds or other indebtedness unless otherwise authorized in the impact fee statute.¹⁷⁵

Where may impact fees be assessed?

¹⁷³ TEX. LOC. GOV’T CODE § 395.001(1).

¹⁷⁴ TEX. LOC. GOV’T CODE § 395.012.

¹⁷⁵ TEX. LOC. GOV’T CODE § 395.013.

Any type of impact fee authorized by Chapter 395 may be imposed within the corporate limits of a city.¹⁷⁶ Impact fees may also be imposed in the extraterritorial jurisdiction (ETJ), except that impact fees may not be imposed in the ETJ for roadway facilities.¹⁷⁷ In areas outside both the corporate boundaries and ETJ, the city may only impose impact fees by contract (but not for roadway facility fees).¹⁷⁸

How much in impact fees may a city charge?

The amount of an impact fee is an amount that may not exceed the cost of capital improvements and facility expansions required by the new development (as calculated by a professional engineer), minus a credit in an amount equal to either: (1) the new property taxes and utility revenue generated by the development; or (2) 50 percent of total costs of the capital improvements, with that figure being divided by the total number of projected service units attributable to the new development.¹⁷⁹ It is up to the city to determine which of the two credits above will be subtracted from the costs when calculating the impact fee.

What is the procedure for adopting an impact fee?

Adoption of an impact fee requires compliance with several detailed steps. These rules are the result of intensive negotiations over the years between cities and developers, and strict compliance with each step is strongly recommended, lest the city open itself up to potential litigation. Following is a summary of the procedural steps:

- (1) **Capital Improvements Plan.** The city must first prepare a draft of a capital improvements plan (CIP). The CIP must be developed by qualified professionals using generally accepted engineering and planning practices.¹⁸⁰ The CIP is a detailed document that forms the basis for calculating precisely what impact fees are permissible for a particular facility.
- (2) **Capital Improvements Advisory Committee.** The city council must appoint an advisory committee to assist with the impact fee process. The statute requires that the committee be appointed sometime before the ordinance setting the public hearing on the CIP and land use assumptions (step four, below).¹⁸¹

The advisory committee must be made up of at least five members. At least 40 percent of the members of the advisory committee must be representatives of the real estate, development, or building community, and not employees or officials of the city.¹⁸²

¹⁷⁶ TEX. LOC. GOV'T CODE § 395.011(b).

¹⁷⁷ TEX. LOC. GOV'T CODE § 395.011(b).

¹⁷⁸ TEX. LOC. GOV'T CODE § 395.011(c).

¹⁷⁹ TEX. LOC. GOV'T CODE § 395.015.

¹⁸⁰ TEX. LOC. GOV'T CODE § 395.0411.

¹⁸¹ TEX. LOC. GOV'T CODE § 395.058(a).

¹⁸² TEX. LOC. GOV'T CODE § 395.058(b).

The advisory committee’s purpose is to: (1) advise and assist the city in adopting the land use assumptions; (2) review the CIP and file written comments at least six business days before the city’s hearing on the proposed impact fees; (3) monitor and evaluate implementation of the CIP; (4) file semiannual reports with respect to the progress of the CIP and report to the city any perceived inequities in implementing the plan or imposing the impact fee; and (5) advise the city of the need to update or revise the land use assumptions, CIP, or impact fee.¹⁸³

- (3) **Land Use Assumptions.** Next, the city must prepare a draft of its “land use assumptions.”¹⁸⁴ Land use assumptions are essentially a document that includes a description of the service area and projections of changes in land uses, densities, intensities, and population in the service area over at least a 10-year period.¹⁸⁵
- (4) **Set Hearing on CIP and Land Use Assumptions.** The council must adopt an order, resolution, or ordinance establishing a public hearing date to consider the CIP and land use assumptions for the “designated service area” (defined as the area served by the facilities funded by the impact fee).¹⁸⁶
- (5) **Make Public CIP and Land Use Assumptions.** After setting the hearing date in step four above, and prior to giving notice of the hearing, the city shall make the CIP and land use assumptions available to the public.¹⁸⁷ Essentially, this means making both documents available for inspection or copying at city hall by any interested person.
- (6) **Notice of Hearing on CIP and Land Use Assumptions.** At least 31 days before the date of the hearing on the CIP and land use assumptions, the city must provide notice of the hearing by both of the following methods:

Certified Mail Notice. The city must send a notice of the hearing by certified mail to any person who has given written notice by certified or registered mail to the city secretary or other designated city official requesting notice of such hearings within two years preceding the date of the order, ordinance, or resolution setting the public hearing.¹⁸⁸

Newspaper Notice. The city must publish notice of the hearing in one or more newspapers of general circulation in each county where the city lies.¹⁸⁹

Both notices, certified mail and published, must contain the following:

¹⁸³ TEX. LOC. GOV’T CODE § 395.058(c) and 395.050.

¹⁸⁴ TEX. LOC. GOV’T CODE § 395.042.

¹⁸⁵ TEX. LOC. GOV’T CODE § 395.001(5).

¹⁸⁶ TEX. LOC. GOV’T CODE § 395.042.

¹⁸⁷ TEX. LOC. GOV’T CODE § 395.043.

¹⁸⁸ TEX. LOC. GOV’T CODE § 395.044(a).

¹⁸⁹ TEX. LOC. GOV’T CODE § 395.044(b).

- (a) A headline that reads exactly as follows: “NOTICE OF PUBLIC HEARING ON LAND USE ASSUMPTIONS AND CAPITAL IMPROVEMENTS PLAN RELATING TO POSSIBLE ADOPTION OF IMPACT FEES”.
 - (b) The time, date, and location of the hearing.
 - (c) A statement that the purpose of the hearing is to consider the land use assumptions and capital improvements plan under which an impact fee may be imposed.
 - (d) A statement that any member of the public has the right to appear at the hearing and present evidence for or against the land use assumptions and capital improvements plan (CIP).¹⁹⁰
- (7) **Hold Public Hearing on CIP and Land Use Assumptions.** At the hearing, the council should allow all who desire to speak for or against the CIP or land use assumptions, or any other topic related to the upcoming impact fees, to present their views to the council.
- (8) **Vote to Adopt an Ordinance Approving the CIP and Land Use Assumptions.** At the conclusion of the hearing, preferably at the same meeting, the council should “determine whether to adopt or reject an ordinance, order, or resolution approving the land use assumptions and capital improvements plan.”¹⁹¹ To comply, there should be a council vote, with a proper agenda posting, on whether or not to adopt such an ordinance, order, or resolution.

Whether this step is a distinct requirement from actually adopting the ordinance (step nine, below) is debatable, but it is the safest course to assume so.

- (9) **Approve CIP and Land Use Assumptions.** Within 30 days after the hearing, the city council must adopt an ordinance, order, or resolution approving the CIP and land use assumptions.¹⁹² The ordinance, order, or resolution approving the CIP and land use assumptions must not be adopted as an emergency measure.¹⁹³
- (10) **Set Hearing on Impact Fees.** After adoption of the ordinance approving the CIP and land use assumptions, and preferably at the same meeting that the ordinance was adopted, the city council must adopt an order or resolution (note: but not an ordinance) setting a public hearing to discuss the imposition of the impact fee.¹⁹⁴
- (11) **Notice of Hearing on Impact Fees.** At least 31 days before the hearing on the imposition of the impact fee, the city must provide notice of the hearing by both of the following methods:

¹⁹⁰ TEX. LOC. GOV’T CODE § 395.044(c).

¹⁹¹ TEX. LOC. GOV’T CODE § 395.045(a).

¹⁹² TEX. LOC. GOV’T CODE § 395.045(b).

¹⁹³ TEX. LOC. GOV’T CODE § 395.045(c).

¹⁹⁴ TEX. LOC. GOV’T CODE § 395.047.

Certified Mail Notice. The city must send a notice of the hearing by certified mail to any person who has given written notice by certified or registered mail to the city secretary or other designated city official requesting notice of such hearings within two years preceding the date of the order, ordinance, or resolution setting the public hearing.¹⁹⁵

Newspaper Notice. The city must publish notice of the hearing in one or more newspapers of general circulation in each county where the city lies.¹⁹⁶

Both notices, certified mail and published, must contain the following:

- (a) A headline that reads exactly as follows: “NOTICE OF PUBLIC HEARING ON ADOPTION OF IMPACT FEES”.
 - (b) The time, date, and location of the hearing.
 - (c) A statement that the purpose of the hearing is to consider the adoption of an impact fee.
 - (d) The amount of the proposed impact fee per service unit.
 - (e) A statement that any member of the public has the right to appear at the hearing and present evidence for or against the plan and proposed fee.¹⁹⁷
- (12) **Advisory Committee Comments.** At least six business days before the hearing on the impact fees, the advisory committee must file written comments concerning the proposed impact fees.¹⁹⁸
- (13) **Hold Public Hearing on Impact Fees.** At the hearing, the council should allow all who desire to speak for or against the impact fees, or any other topic related to the upcoming impact fees, to present their views to the council.
- (14) **Approve Impact Fees.** Within 30 days after the hearing on impact fees, the city council must approve or disapprove the impact fees by order, ordinance, or resolution.¹⁹⁹
- (15) **Five-Year Review.** A city imposing impact fees must hold hearings and update the CIP and land use assumptions at least every five years.²⁰⁰ Chapter 395 of the Local Government Code contains detailed procedures for hearings, review, and amendment of the CIP.²⁰¹

¹⁹⁵ TEX. LOC. GOV'T CODE § 395.049(a).

¹⁹⁶ TEX. LOC. GOV'T CODE § 395.049(b).

¹⁹⁷ TEX. LOC. GOV'T CODE § 395.049(c).

¹⁹⁸ TEX. LOC. GOV'T CODE § 395.050.

¹⁹⁹ TEX. LOC. GOV'T CODE § 395.051.

²⁰⁰ TEX. LOC. GOV'T CODE § 395.052.

²⁰¹ TEX. LOC. GOV'T CODE §§ 395.053-395.0575.

When may an impact fee be collected from a developer?

Once water and wastewater capacity is available, impact fees are generally collectable when the city issues the building permit.²⁰²

When is it too late to levy an impact fee on new development?

If an impact fee ordinance is adopted after the land being developed is platted, fees cannot be assessed on any service unit that receives its building permit within one year after adoption of the impact fee.²⁰³

May impact fees be pledged to repay debt service on a bond, note, or other obligation?

Yes, impact fees may be pledged to pay off bonds and other notes, provided the improvement being paid for is identified in the CIP.²⁰⁴ Further, at the time of the pledge the city council must certify in a written order, ordinance, or resolution that none of the impact fee will be used on an improvement not in the CIP.²⁰⁵

What fees and other development tools are not considered impact fees (and thus not subject to the procedures or restrictions under Chapter 395 of the Local Government Code)?

The following are not considered impact fees, and thus are not subject to the detailed procedures and formulas set forth in Chapter 395: (1) dedication of land for public parks; (2) payment in lieu of the dedication of parks; (3) dedication of rights-of-way or easements of on-site or off-site water distribution, wastewater collection or drainage facilities, or streets, sidewalks, or curbs if the dedication or construction is required by a valid ordinance and is necessitated by and attributable to the new development; (4) construction or dedication of on-site or off-site water distribution, wastewater collection or drainage facilities, or streets, sidewalks, or curbs if the dedication or construction is required by a valid ordinance and is necessitated by and attributable to the new development; (5) lot or acreage fees to be placed in trust funds for the purpose of reimbursing developers for oversizing or constructing water or sewer mains or lines; and (6) other pro rata fees (see *Pro Rata Fees* elsewhere in this manual) for reimbursement of water or sewer mains or lines extended by the political subdivision.²⁰⁶

INTERLOCAL AGREEMENTS

²⁰² TEX. LOC. GOV'T CODE § 395.016(d)(1).

²⁰³ TEX. LOC. GOV'T CODE § 395.016(c).

²⁰⁴ TEX. LOC. GOV'T CODE § 395.012(d)(1).

²⁰⁵ TEX. LOC. GOV'T CODE § 395.012(d)(2).

²⁰⁶ TEX. LOC. GOV'T CODE § 395.001(4).

What are interlocal agreements?

Interlocal agreements are contracts between units of local government, including cities, and other units of local government or the state to perform services or acquire goods on mutually beneficial terms.

In what sense can an interlocal agreement be considered a revenue source?

Cities with “excess” capacity in a service department can benefit by selling that excess capacity to neighboring units of government. For example, suppose that a small but growing city forms its first professional fire department. Such a city may find that demand may not be present within the city for some years to fully utilize the services of the new fire department. Such a city can “sell” its firefighting services to a neighboring city that doesn’t have a fire department through an interlocal agreement. Both cities benefit from such an arrangement, and waste of services and taxes is kept to a minimum.

What types of services may be subject to an interlocal agreement?

Cities may enter interlocal contracts in the following areas: police protection and detention services; fire protection; streets, roads, and drainage; public health and welfare; parks and recreation; library and museum services; records center services; waste disposal; planning; engineering; administrative functions; public funds investment; comprehensive health care and hospital services; or other governmental functions in which the contracting parties are mutually interested.²⁰⁷

Are there any restrictions on what services a city may contract away or for through an interlocal agreement?

First, a city should look to the laundry list above to determine if a service is subject to an interlocal agreement. Despite the broad catch-all at the end of the list—“other governmental functions in which the contracting parties are mutually interested”—cities should not assume that all functions not listed are proper. A city should consult with its attorney prior to entering into any interlocal agreement that doesn’t fit squarely into one of the authorized categories above.

Further, state law requires that an interlocal contract must be for functions or services that each party to the contract is authorized to perform individually.²⁰⁸ For example, cities may engage in zoning, but counties generally cannot. Therefore, a city could not offer zoning services to a county under an interlocal agreement, because a county isn’t authorized to perform that function itself.

²⁰⁷ TEX. GOV’T CODE § 791.003(3).

²⁰⁸ TEX. GOV’T CODE § 791.011(c)(2).

On the other hand, both cities and counties have authority to engage in law enforcement. Therefore, a city could contract with a county for the city to provide police services to the county.

What specific provisions must an interlocal contract contain?

All interlocal agreements must contain each of the following:

- (1) a statement of the purpose, terms, rights, and duties of the contracting parties; and
- (2) a statement that each party paying for the performance of governmental functions or services must make those payments from current revenues available to the paying party.²⁰⁹

How much may a city charge (or pay) under an interlocal agreement?

The amount payable under an interlocal contract must fairly compensate the performing party for the services or functions performed under the contract.²¹⁰

Does payment by the city pursuant to a multi-year interlocal agreement constitute a debt for which the city must create an interest and sinking fund?

No. Voters approved an amendment to the Texas Constitution in 2011 that specifically allows cities and counties to enter into contracts for longer than one year without the contract automatically constituting a debt for which an interest and sinking fund must be created.²¹¹ The purpose of the amendment was to give local governments greater flexibility to utilize interlocal agreements to consolidate more projects and services.

INTERNET PAYMENT AND ACCESS FEES

What are Internet payment and access fees?

A city may charge a fee for providing any of the following services over the Internet: (1) access to municipal information; (2) collection of payments for taxes, fines, fees, court costs, or other charges; or (3) other city services authorized by law.²¹²

²⁰⁹ TEX. GOV'T CODE § 791.011(d).

²¹⁰ TEX. GOV'T CODE § 791.011(e).

²¹¹ TEX. CONST. art. 11, §§ 5(b) and 7(b).

²¹² TEX. LOC. GOV'T CODE § 132.007.

How much of a fee may a city charge for Internet payment, services, or access to information?

A fee must be “reasonable.”²¹³ Further, fees for access to information or for services other than payment of fines, taxes, and other fees, may only be designed to recover the costs directly and reasonably incurred in providing the access or service, and only following a finding by the city council that the provision of information or service through the Internet would not be feasible without the imposition of the fee.²¹⁴

INVESTMENTS

May a city invest its public funds, in order to make money with its money?

Yes, a city may invest its public funds, but only if the city complies with Chapter 2256 of the Texas Government Code, the Public Funds Investment Act (PFIA).

What does the PFIA require of a city before a city may invest its public funds?

Before a city may invest its public funds, the PFIA generally requires the following:

- (1) A city must adopt a written investment policy;
- (2) A city may only invest its funds in investments authorized under its written investment policy;
- (3) Authorized investments must come from the list of proper investments under the PFIA; and
- (4) An official from the city must complete training regarding the requirements of the PFIA.

What is the investment policy requirement?

A city must adopt a written investment policy by ordinance or resolution.²¹⁵ Therefore, regardless of a city’s population, it must have a written investment policy if it has any cash or bank investments. A formal policy protects not only the cash assets of the city, but also the elected and finance management officials.

An investment policy must contain a statement emphasizing safety and liquidity.²¹⁶ If the policy applies to the financial assets of all funds or fund types, that fact should be clearly stated. A

²¹³ TEX. LOC. GOV’T CODE § 132.007(b).

²¹⁴ TEX. LOC. GOV’T CODE § 132.007(c).

²¹⁵ TEX. GOV’T CODE §2256.005(a).

²¹⁶ TEX. GOV’T CODE §2256.005(b)(2).

distinction should be made between shorter-term cash management and the management of longer-term investments.

The policy must also include a list of authorized investments and the permitted maximum maturity of any individual investment, as well as the maximum weighted average maturity (WAM) of funds.²¹⁷ The policy must also include (among other things) the method used by the investing entity to monitor the market price of investments acquired, as well as procedures to monitor rating changes in investments acquired with public funds and the liquidation of such investments.²¹⁸

Although the actual investment strategy for smaller cities is vastly different from larger cities, the primary objectives, which should direct any investment strategy, are safety and liquidity. Safety is the most important objective, because public officials have a fiduciary responsibility to manage and maintain taxpayer funds. The PFIA requires governing bodies of local governments and state agencies to invest public funds under their control with the same prudence and discretion as such entities would manage their own affairs.

Liquidity, the ability to sell or dispose of an investment, is equally important. Invested funds must be readily available if the need for cash arises and requires the city to liquidate the investment before maturity.

Yield refers to the rate of return received on a particular investment. Yield or income derived from an investment is important, particularly to a city grappling with declining or stagnant revenues or tax base. However, 1995 amendments to the Act significantly revised the ranking of investment objectives and put yield in last place.²¹⁹ The first priority for consideration is the suitability of the investment to the overall cash flow and financial requirements of the entity.²²⁰

The PFIA requires that the governing body of an investing entity review its investment policy at least once a year.²²¹ Moreover, the governing body must take formal action stating that the policy and strategy have been reviewed. Any changes to either the policy or strategy must be recorded in the resolution and the investment policy. Changed policies should be sent to all brokers, pools, and advisors. The investing entity must also designate by ordinance or resolution the employee or investment officer(s) who will be responsible for the investment of its funds.²²² The policy also should refer to training seminars conducted by independent sources, such as the Texas Municipal League.

What is the training requirement under the PFIA?

²¹⁷ TEX. GOV'T CODE §2256.005(b)(4)(a) & (c).

²¹⁸ TEX. GOV'T CODE §2256.005(b)(4)(d) & (f).

²¹⁹ TEX. GOV'T CODE §2256.005(d).

²²⁰ TEX. GOV'T CODE §2256.005(d).

²²¹ TEX. GOV'T CODE §2256.005(e).

²²² TEX. GOV'T CODE §2256.005(f).

The treasurer, the chief financial officer (if the treasurer is not the chief financial officer), and the investment officer of a local government must attend at least one, ten-hour, training session in investment laws within twelve months after taking office.²²³ The PFIA is written in a way that requires all cities to appoint someone to one of these positions in order to receive the training. On a continuing basis, the investment training sessions must be attended at least once every two-year period for at least eight hours of instruction. The two-year period begins on the first day of the city's fiscal year and consists of the two consecutive years after that date.²²⁴

As of September 1, 1999, the entity that provides training must report to the comptroller a list of the governmental entities that received training. Further, auditors and credit rating agencies are increasingly paying attention to whether a city is up-to-date on its required training. The Texas Municipal League offers training, as do other entities. City officials may check for upcoming PFIA workshops on the TML website at tmlpfia.org.

According to the PFIA, what are the legal investment tools that a city may include in its investment policy?

The PFIA limits the types of investments that a city may authorize under its investment policy. Essentially, an investment must be legal under the PFIA, and included in the city's investment policy, before a city may use that investment.

Following are the legal investments under the PFIA:

- (1) **Governmental Obligations.** United States (including the Federal Home Loan Banks) and State of Texas obligations, such as bonds, are legal investments. So are obligations of local governments, provided the obligations are "A" rated. Certain interest-backed banking deposits are permitted as well. Mortgage-backed obligations are not legal, however.²²⁵
- (2) **Certificates of Deposit (CDs).** CDs are a legal investment provided they are issued by a bank or authorized broker with its main office or a branch office in Texas.²²⁶ CDs must be collateralized (secured) for amounts greater than FDIC insurance (\$250,000).
- (3) **Repurchase Agreements.** Certain fully-collateralized repurchase agreements are legal investments.²²⁷
- (4) **Securities Lending Programs.**²²⁸
- (5) **Banker's Acceptances.**²²⁹
- (6) **Commercial Paper.** Commercial paper is a legal investment if it has a maturity date of 365 days or less and is rated at least "A-1" or "P-1" by at least two credit rating agencies.²³⁰

²²³ TEX. GOV'T CODE §2256.008.

²²⁴ TEX. GOV'T CODE §2256.008(a-1).

²²⁵ TEX. GOV'T CODE §2256.009.

²²⁶ TEX. GOV'T CODE §2256.010.

²²⁷ TEX. GOV'T CODE §2256.011.

²²⁸ TEX. GOV'T CODE §2256.0115.

²²⁹ TEX. GOV'T CODE §2256.012.

- (7) **Certain Mutual Funds.**²³¹ (See below for details about legal mutual funds).
- (8) **Guaranteed Investment Contracts.** Guaranteed investment contracts are legal investments if they have a defined termination date, are fully secured, and are pledged to the city.²³²
- (9) **Investment Pools.** Investment pools are legal investment vehicles if: (a) the city council passes an ordinance or resolution authorizing investment pools; (b) the investment officer of the city receives a detailed prospectus from the pool; (c) the pool makes detailed periodic reports to the city; and (d) the pool is continuously rated “AAA” or “AAA-m”.²³³ An investment pool may invest its funds in money market mutual funds to the extent permitted by state law and the investment policies and objectives adopted by the pool.²³⁴
- (10) **Municipal Utility.** A city that owns an electric utility may enter into a hedging contract and related security and insurance agreements in relation to fuel oil, natural gas, coal, nuclear fuel, and electric energy to protect against loss due to price fluctuations.²³⁵
- (11) **Municipal Funds from Management and Development of Mineral Rights.** A city may invest excess funds derived from contracts or leases made on city-owned mineral rights in any investment authorized to be made by a trustee under the Texas Trust Code.
- (12) **Decommissioning Trust.** A city that owns an electric utility may invest funds held in a nuclear generation facility decommissioning trust in any investment authorized by the Texas Trust Code.
- (13) **Hedging Transaction.** A city with a principal amount of at least \$250 million in outstanding long-term indebtedness or long-term indebtedness proposed to be issued that is rated in one of the four highest rating categories by a nationally recognized rating agency for municipal securities may invest in a hedging transaction, including a hedging contract.²³⁶ Before investing in a hedging transaction, the governing body of an eligible entity must first establish the entity’s policy regarding hedging transactions.²³⁷

May a city invest in corporate stocks?

No. Stocks, also known as equities, are not listed among the legal investments under the PFIA.

Which mutual funds may a city invest in?

²³⁰ TEX. GOV’T CODE §2256.013.

²³¹ TEX. GOV’T CODE §2256.014.

²³² TEX. GOV’T CODE §2256.015.

²³³ TEX. GOV’T CODE §2256.016.

²³⁴ TEX. GOV’T CODE §2256.016.

²³⁵ TEX. GOV’T CODE §2256.0201.

²³⁶ TEX. GOV’T CODE §2256.0206(a).

²³⁷ TEX. GOV’T CODE §2256.0206(c).

It depends. Essentially, whether a city can invest in a mutual fund, and how much, depends on the type of mutual fund in question. An outline of the law for each type of permissible mutual fund follows, but it is recommended that the investment officer read the statute in question before making the investment²³⁸:

- (1) A city may invest in no-load money market mutual funds only if all of the following are true:
 - (a) the fund is registered and regulated by the Securities and Exchange Commission (SEC);
 - (b) the fund provides a certain type of prospectus;
 - (c) the fund complies with SEC rules related to money market mutual funds; and
 - (d) the city's investments do not exceed ten percent of the value of the fund.

- (2) A city may invest in other no-load mutual funds (that is, non-money market) only if all of the following are true:
 - (a) the fund is registered with the SEC;
 - (b) the fund has an average weighted maturity of less than two years;
 - (c) the fund either: (i) has a duration of one year or more and invests exclusively in obligations already approved elsewhere in the Public Funds Investment Act (thus excluding most stock funds); or (ii) has a duration of less than one year and the investment portfolio is limited to investment grade securities, excluding asset-backed securities;
 - (d) the city invests no more than 15 percent of its eligible funds in the mutual fund (i.e., excluding the city's bond and debt funds);
 - (e) the city does not invest its bond or debt service funds in this type of fund; and
 - (f) the city's investments do not exceed ten percent of the value of the fund.

Of course, the PFIA does not permit investment of any city funds until the city adopts a written investment policy that authorizes each type of investment in question. A written investment policy that does not authorize mutual funds would thus exclude their use, despite state law.

Once the city has complied with the training and written investment policy requirements, can the city then invest in any certificates of deposit?

No. Eligible investment CDs must be issued by a Texas bank or a national bank domiciled in Texas, or a state or federal credit union domiciled in Texas. Further, the CD must be guaranteed or insured by the FDIC or National Credit Union Share Insurance Fund, and must be secured by collateral, just as ordinary municipal deposits, for amounts greater than \$250,000.²³⁹

²³⁸ TEX. GOV'T CODE § 2256.014.

²³⁹ TEX. GOV'T CODE §2256.010.

What is the consequence of failure to comply with the PFIA training requirements?

Though the PFIA contains no penalty provision, auditors and credit rating agencies are increasingly knowledgeable about its requirements. Failure to obtain the necessary training could result in negative marks on the city's audit, or a downgrade in a city's credit rating, which could affect municipal borrowing.

LOCAL CONSOLIDATED COURT FEE

What is the local consolidated court fee?

Legislation passed in 2019 in the form of S.B. 346 consolidated a handful of local option municipal court fees into one local consolidated court fee. The local consolidated court fee is a \$14 fee assessed on a person convicted of a nonjailable misdemeanor.²⁴⁰ The city is responsible for collecting the fee and establishing four different accounts to which the fee revenue is assigned. The new legislation requires the fee revenue to be apportioned as follows: (1) 35.7143 percent (\$5.00 of each fee) to the Local Truancy Prevention and Diversion Fund; (2) 35 percent (\$4.90) to the Municipal Court Building Security Fund (3) 28.5714 percent (\$4.00) to the Municipal Court Technology Fund; and (4) .7143 percent (\$.10) to the Municipal Jury Fund.²⁴¹

Prior to the passage of S.B. 346, cities had to adopt ordinances in order to impose fees dedicated to municipal court building security, municipal court technology, and juvenile case managers. S.B. 346 removes the "local option" component to these fees. Now, every city is required to assign a portion of the local consolidated court fee revenue to building security, court technology, and juvenile case managers (through the local truancy prevention and diversion fund) without regard for whether or not the city formally adopted the fee.

The fee is applied only to people "convicted" of offenses. How is that term interpreted?

The Code of Criminal Procedure defines "conviction" quite broadly with respect to triggering the local consolidated court fee. A person is considered to have been convicted in a case, for purposes of collecting the local consolidated court fee, if: (1) a judgment, a sentence, or both a judgment and a sentence are imposed on the person; (2) the person receives community supervision, deferred adjudication, or deferred disposition; or (3) the court defers final disposition of the case or imposition of the judgment and sentence.²⁴² Thus, most routine dispositions of criminal cases in municipal court, short of acquittal or dismissal, trigger the local consolidated court fee.

²⁴⁰ TEX. LOC. GOV'T CODE § 134.103(a).

²⁴¹ TEX. LOC. GOV'T CODE § 134.103(b).

²⁴² TEX. LOC. GOV'T CODE § 134.002(b).

How is the local consolidated court fee collected?

The municipal court clerk is required to collect the local consolidated court fee and remit the revenue to the city treasurer, who then must deposit the funds in the municipal treasury.²⁴³

What may money in the local truancy prevention and diversion fund be spent on?

Prior to the passage of S.B. 346, cities had the option to adopt an ordinance establishing a juvenile case manager fee. S.B. 346 repeals that authority, but in establishing the local truancy prevention and diversion fund, authorizes the local consolidated court fee revenue dedicated to the fund to be used in the same ways as the juvenile case manager fee.

A city may use money in the local truancy prevention and diversion fund to finance the salary, benefits, training, travel expenses, office supplies, and other necessary expenses related to the position of a juvenile case manager employed pursuant to Code of Criminal Procedure Art. 45.056.²⁴⁴ If there is money left in the fund after those costs are paid, a juvenile case manager is authorized—subject to the direction of the city council and on approval by the municipal court—to direct the remaining money to be used to implement programs directly related to the duties of the juvenile case manager, including juvenile alcohol and substance abuse programs, educational and leadership programs, and any other projects designed to prevent or reduce the number of juvenile referrals to the court.²⁴⁵

What if the city does not employ a juvenile case manager?

The statute is unclear on this point. Because the city council maintains some discretion to spend funds that aren't used on the juvenile case manager on programs directly related to the duties of a juvenile case manager, cities without juvenile case managers might be able to spend funds in this manner. However, the statute expressly prohibits money in the local truancy prevention and diversion fund from being used to supplement the income of an employee whose primary role is not that of a juvenile case manager.²⁴⁶

What may money in the municipal court building security fund be spent on?

The revenue in the municipal court building security fund may only be spent to finance security personnel, services, and items related to buildings that house the operations of municipal courts, including:

- (1) X-ray machines and conveying systems;

²⁴³ TEX. LOC. GOV'T CODE §§ 134.002(a)(2) and 134.0051.

²⁴⁴ TEX. LOC. GOV'T CODE § 134.156(a).

²⁴⁵ TEX. LOC. GOV'T CODE § 134.156(a).

²⁴⁶ TEX. LOC. GOV'T CODE § 134.156(b).

- (2) Handheld metal detectors;
- (3) Walkthrough metal detectors;
- (4) Identification cards and systems;
- (5) Electronic locking and surveillance equipment;
- (6) Video teleconferencing systems;
- (7) Bailiffs of contract security personnel during times when they are providing appropriate security services;
- (8) Signage;
- (9) Confiscated weapon inventory and tracking systems;
- (10) Locks, chains, alarms, or similar security devices;
- (11) Bullet-proof glass;
- (12) Continuing education on security issues for court and security personnel; and
- (13) Warrant officers and related equipment.²⁴⁷

What may money in the municipal court technology fund be spent on?

The fees in the municipal court technology fund may only be spent to purchase or maintain technological enhancements for a municipal court's operations, including: (1) computer systems; (2) computer networks; (3) computer hardware; (4) computer software; (5) imaging systems; (6) electronic kiosks; (7) electronic ticket writers; and (8) docket management systems.²⁴⁸

What may money in the municipal jury fund be spent on?

Revenue allocated to the municipal jury fund may be used by a city only to fund juror reimbursements and otherwise finance jury services.²⁴⁹

²⁴⁷ TEX. CRIM. PROC. CODE § 102.017(c).

²⁴⁸ TEX. CRIM. PROC. CODE § 102.0172(b).

²⁴⁹ TEX. LOC. GOV'T CODE § 134.154.

MUNICIPAL COURT FINES

What are municipal court fines?

Fines are the monetary punishment meted out by municipal courts. Not all cities operate municipal courts; to levy fines, cities must first operate a court.

How much of a municipal court fine may be levied?

Municipal courts hear Class C criminal prosecutions, which mean cases punishable by fine only. Some Class C offenses are created by state statute, in which case the statute would set the maximum fine. Traffic tickets, for example, are typically punishable by a maximum fine of \$200.²⁵⁰

Cities can also create Class C offenses for violations of their own ordinances. With one exception, the maximum amount for fines created by ordinance is \$500 for ordinary offenses, and \$2000 for offenses relating to fire safety, zoning, or public health and sanitation.²⁵¹ In 2015, legislation passed authorizing a city to impose a fine of up to \$4,000 for the violation of a rule, ordinance, or police regulation that governs the dumping of refuse.²⁵²

What may a city spend municipal court fine revenue on?

Fine revenue for offenses other than traffic violations is general revenue of the city and thus may be spent on any lawful purpose.

Fine revenue for state law traffic violations must be used to construct and maintain roads, bridges, and culverts in the city, and to enforce laws regulating the use of highways by motor vehicles.²⁵³

What role does the city council have in setting fine amounts?

Cities that create ordinances with fines attached may set the maximum amount of the fine in the ordinance, up to the limits allowed by state law. Beyond creating the ordinance, however, the amount of fines in individual cases is entirely up to the municipal court judge and/or jury.

²⁵⁰ TEX. TRANSP. CODE § 542.401.

²⁵¹ TEX. LOC. GOV'T CODE § 54.001(b).

²⁵² TEX. LOC. GOV'T CODE § 54.001(b).

²⁵³ TEX. TRANSP. CODE § 542.402(a).

See Chapter: *Traffic Fine Revenue*

MUNICIPAL DEVELOPMENT CORPORATION SALES **TAX**

What is a municipal development corporation?

A municipal development corporation (not to be confused with a Type A or Type B *economic* development corporation) is a little-used city economic development tool that focuses on workforce training and development. The legislation authorizing municipal development corporations (MDCs) was passed in 2001 and is titled the “Better Jobs Act.” MDCs are ideal for long-term job training and early childhood development programs within cities. The statute authorizing MDCs is located in Chapter 379A of the Local Government Code.

How are MDCs funded?

A city may call an election to levy a sales tax to fund an MDC’s programs.²⁵⁴ The sales tax may be levied at the rate of one-eighth, one-fourth, three-eighths, or one-half of one percent.²⁵⁵ The tax must be reauthorized every 20 years.²⁵⁶

What may an MDC spend its sales tax revenues on?

An MDC may fund programs for: (1) job training; (2) early childhood development that prepares children to enter school; (3) after-school programs for primary and secondary schools; (4) postsecondary institutions and scholarships; (5) literacy programs; and (6) any other undertaking that the MDC’s board determines will facilitate the development of a skilled workforce within the city.²⁵⁷

How does an MDC operate?

Similar to an economic development corporation, an MDC is governed by a board of directors that is appointed by—and serves at the will of—the city council.²⁵⁸ A director may not be an employee or officer of the city that created the MDC.²⁵⁹

²⁵⁴ TEX. LOC. GOV’T CODE § 379A.081(a).

²⁵⁵ TEX. LOC. GOV’T CODE § 379A.081(e).

²⁵⁶ TEX. LOC. GOV’T CODE § 379A.081(d).

²⁵⁷ TEX. LOC. GOV’T CODE § 379A.051(a).

²⁵⁸ TEX. LOC. GOV’T CODE § 379A.021.

²⁵⁹ TEX. LOC. GOV’T CODE § 379A.021(e).

Does the city council have oversight over the MDC?

Yes. The budget for MDC program expenditures, as well as any budget amendments, must be approved by the city council.²⁶⁰ The MDC's budget that is presented to the city council must include a detailed description of proposed expenditures.²⁶¹ Further, two-thirds of the city council can vote to amend the MDC's budget.²⁶² The MDC board must prepare annual financial statements to be presented to the city council, and the city council is entitled to the records of the MDC at all times.²⁶³

May an MDC be limited as to which programs it may pursue?

Yes, the city council may provide that an MDC's sales tax ballot proposition be limited to specific programs, rather than all of the purposes authorized by the MDC statute.²⁶⁴ For instance, a city council could ensure that MDC revenues be spent only on job training, and not on other projects that the council might wish to avoid, by limiting the ballot proposition to job training projects.

MUNICIPAL DEVELOPMENT DISTRICT (MDD) **SALES TAX**

What is a municipal development district sales tax?

An MDD is a political subdivision created by a city to plan, acquire, establish, develop, construct, or renovate one or more development projects beneficial to the district.²⁶⁵ An MDD closely resembles a Type B economic development corporation (EDC), with some key differences (discussed below). The MDD is funded through a dedicated local sales and use tax that must be approved by the voters in an election held within the district.²⁶⁶ *Id.* § 377.101.

The concept of an MDD was first introduced in a limited capacity in 1999, when the Texas Legislature authorized the City of Aransas Pass to create an MDD. In 2001, legislation passed to provide that any city located in multiple counties could hold an election to adopt an MDD. Finally, in 2005, the Texas Legislature amended Chapter 377 of the Local Government Code to enable any city to establish an MDD.

²⁶⁰ TEX. LOC. GOV'T CODE § 379A.025(a).

²⁶¹ TEX. LOC. GOV'T CODE § 379A.025(c).

²⁶² TEX. LOC. GOV'T CODE § 379A.025(b).

²⁶³ TEX. LOC. GOV'T CODE §§ 379A.025(d) and (e).

²⁶⁴ TEX. LOC. GOV'T CODE § 379A.081(c).

²⁶⁵ TEX. LOC. GOV'T CODE §§ 377.021 and 377.022.

²⁶⁶ TEX. LOC. GOV'T CODE § 377.101.

How much can the MDD sales tax levy be?

The rate of an MDD sales tax may be one-eighth, one-fourth, three-eighths, or one-half of one percent of the cost of goods sold within the MDD that are subject to sales taxes.²⁶⁷ The combined rate of all local sales taxes within the district, however, cannot exceed two percent.²⁶⁸

What may an MDD sales tax be spent on?

An MDD sales tax is a dedicated city sales tax, meaning its proceeds can only be spent on certain authorized projects (as distinguished from a general purpose tax, which can be spent on any lawful city purpose).

An MDD sales tax is an economic development tax that can be spent on authorized “development projects,” which include any of the following:

- (1) Any “project” as that word is defined by Sections 505.051 through 505.158 of the Local Government Code.²⁶⁹ In other words, the MDD tax automatically encompasses any project available to a similarly-sized Type B economic development corporation.
- (2) A convention center facility or related improvements such as a civic center or auditorium.²⁷⁰
- (3) Parking lots for such convention or related facilities.²⁷¹
- (4) Civic center hotels.²⁷² This authority can be quite important; funding of civic center hotels with other funds, such as hotel occupancy taxes, is controversial both legally and politically.

Can an MDD be created to encompass the city’s extraterritorial jurisdiction (ETJ)?

Yes. When a city holds the election to create a district, the district may be created in: (1) all or part of the boundaries of the city; (2) all or part of the boundaries of the city and all or part of the boundaries of the city’s ETJ; or (3) all or part of the city’s ETJ.²⁷³

While the MDD statute authorizes the boundaries of the MDD to include the city’s ETJ upon the creation of the district, it should be noted that there is no express statutory authority to later modify the boundaries of the ETJ. In other words, an MDD that is initially created to only

²⁶⁷ TEX. LOC. GOV’T CODE § 377.104.

²⁶⁸ TEX. LOC. GOV’T CODE § 377.101(c).

²⁶⁹ TEX. LOC. GOV’T CODE § 377.001(3)(A).

²⁷⁰ TEX. LOC. GOV’T CODE § 377.001(3)(B).

²⁷¹ TEX. LOC. GOV’T CODE § 377.001(3)(B).

²⁷² TEX. LOC. GOV’T CODE § 377.001(3)(B).

²⁷³ TEX. LOC. GOV’T CODE § 377.002.

include the city limits cannot later be expanded—by election or otherwise—to include the city’s ETJ.

If the MDD sales tax so closely resembles a Type B economic development sales tax, why not just enact a Type B economic development tax instead?

There are several distinctions between an MDD tax and a Type B tax that might make the MDD tax preferable to a particular city:

- (1) The scope of projects that can be funded with an MDD sales tax is slightly larger than a Type B sales tax (see above);
- (2) An MDD sales tax need not be levied over the entire corporate limits of a city, as a Type B sales tax must. This can be useful for cities that straddle county boundaries and are thus “maxed out” at their two-percent local sales tax cap in some areas of the city but not in others. The statute states that the city can create the district (and thus levy the tax) in “all or part of the boundaries of the municipality.”²⁷⁴ A city might choose to limit the application of the tax to certain areas of the city for other reasons as well, including economic development considerations.
- (3) As mentioned above, an MDD sales tax may be imposed in a city’s extraterritorial jurisdiction (ETJ) if the voters of the entire district approve the tax.²⁷⁵ The MDD sales tax is the only city sales tax that may be levied in the ETJ of a city.
- (4) The MDD statute does not have the same level of detailed restrictions that the Type B statute does. For example, the EDC statute prevents the city from giving aid to an EDC.²⁷⁶ The MDD statute contains no such restriction. The MDD statute only references the Type B law to define the permissible projects of an MDD; it does not incorporate the other procedural and substantive aspects of the EDC statutes.
- (5) The board of an MDD consists of a minimum of four persons.²⁷⁷ A Type B corporation has a seven-member board.²⁷⁸ Many Type B cities, particularly smaller cities, report difficulty in locating persons willing to serve on the Type B board. The smaller MDD board can help in this regard.

Can an MDD spend its revenue for authorized projects outside the district?

One area where MDDs clearly have less flexibility than an EDC relates to spending on projects located outside the boundaries of the district. An EDC may undertake projects outside of the city

²⁷⁴ TEX. LOC. GOV’T CODE § 377.002(a)(1).

²⁷⁵ TEX. LOC. GOV’T CODE § 377.002(a)(2).

²⁷⁶ TEX. LOC. GOV’T CODE § 501.007(a).

²⁷⁷ TEX. LOC. GOV’T CODE § 377.051(a).

²⁷⁸ TEX. LOC. GOV’T CODE § 505.051.

limits with permission of the governing body that has jurisdiction over the property.²⁷⁹ For instance, if a potential project is located completely within the jurisdiction of another city, the corporation would need approval of the city council of that city before funding the project.

An MDD, on the other hand, is only authorized to fund projects located within the boundaries of the district. As a general matter, an MDD may use money in the development project fund only to “pay the costs of planning, acquiring, establishing, developing, constructing, or renovating one or more development projects *in the district*.” (Emphasis added.)²⁸⁰ So if the boundaries of an MDD include only the corporate boundaries of the city, the MDD is not clearly authorized to spend money on projects located in the ETJ.

Is an MDD required to follow certain procedures when selling or conveying real property owned by the MDD?

Yes. Unlike an EDC, an MDD is considered to be a political subdivision of the state.²⁸¹ As such, an MDD must comply with laws that are generally applicable to political subdivisions. This includes Chapter 272 of the Local Government Code, which establishes a notice and bidding process for the sale of real property by a political subdivision.

Is an MDD required to have bylaws?

No. Chapter 377 of the Local Government code is silent regarding the adoption of MDD bylaws. Because MDDs operate in a similar manner to EDCs, and state statute specifically provides for the creation of EDC bylaws, many cities also adopt MDD bylaws. Unlike EDCs, there is no specific procedure to follow to adopt or amend MDD bylaws.

The ability of a Type B corporation to fund commercial and retail economic development projects depends on the size and/or Type B revenues of the city. Does this distinction extend to an MDD sales tax as well?

The likely answer is yes. The MDD statute, when listing eligible projects that can be funded by the MDD sales tax, incorporates by reference the section of the Type B laws that contains the population/revenue distinction with respect to commercial and retail projects.²⁸²

Thus, a court would likely find that the ability of an MDD to engage in general commercial and retail economic development projects depends on the same population/revenue distinction that is contained in the Type B statute.

²⁷⁹ TEX. LOC. GOV'T CODE § 501.159.

²⁸⁰ TEX. LOC. GOV'T CODE § 377.072(a).

²⁸¹ TEX. LOC. GOV'T CODE § 377.022.

²⁸² TEX. LOC. GOV'T CODE § 377.001(3)(A).

Specifically, an MDD district with less than 20,000 population, *or* less than \$50,000 in revenues from the MDD sales tax in each of the two preceding years, may fund commercial and retail economic development projects with the MDD sales tax.²⁸³

MDDs that don't meet either of those criteria would be limited to Type B projects other than commercial and retail. Typically, such projects are of a more "blue collar" variety (the statute uses the term "primary jobs"), such as industry and manufacturing, as well as certain targeted infrastructure projects, and recreational and community facilities, among other things. Such a district would still have the additional projects available to it such as convention centers and civic center hotels.

What is the procedure for levying an MDD sales tax?

Following are the procedures for levying an MDD sales tax.

- (1) **Draft Order of Election.** The city must draft an order that does the following: (a) defines the boundaries of the proposed MDD; (b) calls for an election to be held within those boundaries for the creation of the district and the levy of a sales tax, with the ballot proposition containing the following exact language:

*“Authorizing the creation of the _____ Municipal Development District (insert name of district) and the imposition of a sales and use tax at the rate of _____ of one percent (insert one-eighth, one-fourth, three-eighths, or one-half, as appropriate) for the purpose of financing development projects beneficial to the district.”;*²⁸⁴ and

(c) provides that the district boundaries automatically conform to any changes in the boundaries of the city or the ETJ (this provision is optional).²⁸⁵

- (2) **Call the Election.** The city council calls the election on creation of the MDD and the MDD sales tax by passing the order in step 1 above at a properly noticed public meeting.²⁸⁶
- (3) **Conduct the Election.** The city holds the election on the creation of the MDD and the MDD sales tax on one of the two uniform election dates under Section 41.001 of the Texas Election Code (the first Saturday in May, or the first Tuesday after the first Monday in November).²⁸⁷
- (4) **Notify Comptroller.** If the election is successful, the city should send a copy of the order and canvass documents to the comptroller's office, and request that the comptroller begin

²⁸³ TEX. LOC. GOV'T CODE §§ 505.156 and 505.158.

²⁸⁴ TEX. LOC. GOV'T CODE § 377.021(b).

²⁸⁵ TEX. LOC. GOV'T CODE § 377.021(g).

²⁸⁶ TEX. LOC. GOV'T CODE § 377.021(a).

²⁸⁷ TEX. LOC. GOV'T CODE § 377.021(g).

remitting the MDD sales tax to the city. The new tax won't officially be in effect until the first day of the first calendar quarter occurring after the expiration of the first complete quarter occurring after the date on which the comptroller receives a notice of the results of the election adopting, changing, or repealing the tax.²⁸⁸

- (5) **Appoint the MDD Board.** The city council should next appoint a board of directors to govern the MDD. The board must consist of at least four members, who serve staggered two-year terms.²⁸⁹ Directors may be removed by the city council at any time without cause. Board members must reside in the city that created the MDD or in the city's ETJ. City councilmembers, city officers, and city employees may be members of the board, but may not have a personal interest in a contract executed by the district.²⁹⁰
- (6) **Establish Development Project Fund.** The board of the MDD then must pass a resolution establishing the "development project fund."²⁹¹ It is into this fund that the sales tax proceeds are deposited and spent on authorized MDD projects (see above).

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

Section 321.409 of the Texas Tax Code authorizes a city to repeal or lower one city sales tax, and raise or adopt a different city sales tax, all with one combined ballot proposition. 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.²⁹²

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

²⁸⁸ TEX. LOC. GOV'T CODE § 377.106.

²⁸⁹ TEX. LOC. GOV'T CODE § 377.051(c).

²⁹⁰ TEX. LOC. GOV'T CODE § 377.021(d).

²⁹¹ TEX. LOC. GOV'T CODE § 377.072(a).

²⁹² TEX. TAX CODE § 321.409(b).

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.

May MDD sales taxes be pledged to pay off bonds?

Yes, MDD sales taxes may be pledged to pay off bonds, including revenue and refunding bonds, or other obligations to pay the costs of a legal MDD development project.²⁹³

OPEN RECORDS CHARGES

What are open records charges?

Open records charges are fees that a city is authorized to charge in order to reimburse the city for the expense of providing copies of public records in compliance with Public Information Act requests.

How much may a city charge persons who request copies of open records?

If the city is required to produce copies of 51 or more pages of public records, the city may charge an amount that reasonably includes all costs related to reproducing the public information, including costs of materials, labor, and overhead.²⁹⁴

When providing a requestor 50 or fewer pages of public records, the city may only charge the cost of the photocopying itself, unless the pages to be photocopied are located in two or more separate buildings that aren't physically connected or in a remote storage facility.²⁹⁵

While the statute says that a city is entitled to recover its actual costs, the statute also authorizes the attorney general to promulgate rules that effectively limit the maximum amount that can be charged per photocopy. To summarize the combined effect of the statutes and rules, a city can ultimately charge the *lower* of (1) the actual cost of photocopying per page; or (2) 12.5 cents per page (ten cents, as authorized by attorney general rule, plus a 25-percent cushion allowed by Government Code Section 552.262(a)).

What must a city do if the charge for copies of records will be costly?

²⁹³ TEX. LOC. GOV'T CODE § 377.073.

²⁹⁴ TEX. GOV'T CODE § 552.261(a).

²⁹⁵ TEX. GOV'T CODE § 552.261(a).

If the charges for compliance with a request for public records will exceed \$40, the city must first give the requestor a written, itemized statement that details all the estimated charges, as well as informs the requestor what his or her rights are under the statute.²⁹⁶ After giving the requestor such a letter, the city then waits for the requestor to respond whether or not the charges are acceptable before making the copies. A request is considered withdrawn if the city doesn't receive a response back from the requestor within ten business days after the itemized statement was sent.²⁹⁷

How does a city charge for its labor?

To recap, a city may generally only charge for the labor involved in producing copies if 51 or more copies are requested. If so, the city may charge \$15 an hour for staff time involved in locating, compiling, and reproducing public information.²⁹⁸

When a charge for public records includes labor, the requestor has the right to request a free written statement outlining how the labor charges were computed.²⁹⁹

May a city require an up-front deposit from the requestor for expensive requests?

A requestor may be required to post an up-front deposit or bond if both of the following are true:

- (1) The city has given the requestor the written itemized statement referred to above (for requests that will exceed \$40)³⁰⁰;
- (2) The charge for providing the copies will exceed \$100 if the government has more than 15 full-time employees or \$50 if the governmental body has fewer than 16 full-time employees.³⁰¹

What about charges of copies for things other than paper?

As with paper copies, the city may charge the lower of the actual costs to make the copy, or the rate provided for under attorney general rules plus 25 percent.³⁰² For example, the maximum charge for a DVD is \$3.00.³⁰³

²⁹⁶ TEX. GOV'T CODE § 552.2615(a).

²⁹⁷ TEX. GOV'T CODE § 552.2615(b).

²⁹⁸ 1 TEX. ADMIN. CODE § 70.3.

²⁹⁹ TEX. GOV'T CODE § 552.261.

³⁰⁰ TEX. GOV'T CODE § 552.263(a).

³⁰¹ TEX. GOV'T CODE § 552.263(a).

³⁰² TEX. GOV'T CODE § 552.262(a).

³⁰³ 1 TEX. ADMIN. CODE § 70.3(b)(2)(G).

PROPERTY TAX FOR GENERAL REVENUE

What is the property tax for general revenue?

Any city may adopt a tax on the value of land, improvements, and certain personal property. Such a tax is sometimes referred to as the *ad valorem* tax, which is Latin for “according to value.” Of the over 1,200 incorporated cities in Texas, 1,071 levy a property tax for general revenue.³⁰⁴

According to a recent survey conducted by TML, property taxes are the leading source of city revenue, accounting for 36 percent of city revenues on average statewide. Sales taxes are second at 23 percent.

As the largest source of revenue for many cities, combined with the fact that the rate is somewhat flexible from year to year, property taxes for general revenue tend to serve as a financial buffer that can smooth out yearly fluctuations in other revenue sources. Property taxes are also closely tied by law and practice to a city’s budget calendar.

How is a property tax adopted?

Unlike adopting sales taxes, setting a property tax (including the first tax adopted by a city) does not require an election of the citizens. The council simply adopts the tax by ordinance prior to September 30 of each year.³⁰⁵

What does Senate Bill 2 from 2019 do?

Senate Bill 2, also known as the Texas Property Tax Reform and Transparency Act of 2019, was passed by the Texas Legislature in 2019. At its most fundamental level, S.B. 2 reforms the system of property taxation in three primary ways: (1) lowering the tax rate a taxing unit can adopt without voter approval and requiring a mandatory election to go above the lowered rate; (2) making numerous changes to the procedure by which a city adopts a tax rate; and (3) making several changes to the property tax appraisal process.

Do property taxes need to be approved by the voters?

City officials considering imposing a property tax for the first time often ask if citizen approval of property taxes is necessary. In addition, officials sometimes ask if they can go to the voters anyway for political “cover” because property taxes tend to be very controversial.

³⁰⁴ Texas Comptroller, *Biennial Property Tax Report* - Tax Years 2016 and 2017, pg. 6.

³⁰⁵ TEX. TAX CODE § 26.05(a).

The answer to both questions is no, at least when it comes to the first property tax rate adopted in a city. According to the Texas Tax Code: “The governing body of each taxing unit...shall adopt a tax rate for the current tax year and shall notify the assessor for the unit of the rate adopted.”³⁰⁶ The decision to adopt an initial property tax rate belongs only to the city council.

However, once a city establishes a property tax rate, adopting a rate in subsequent years can require voter approval. Cities are required to receive voter approval if they adopt property tax rates exceeding certain thresholds, which were altered by S.B. 2 in 2019. For cities over 30,000 in population, in addition to a handful of cities under 30,000 in population with a large property tax base, the trigger for an automatic election to approve the property tax rate is called the “voter-approval rate.” The voter-approval rate brings in 3.5 percent more maintenance and operations tax revenue than the previous year on existing properties, and cities can include “banked” amounts from the three preceding years if the city adopted a rate lower than the voter-approval rate in any of those years.³⁰⁷

Most cities under 30,000 in population must keep their adopted property tax rate below the “de minimis rate” to avoid an automatic election. The de minimis rate is the rate necessary to generate an additional \$500,000 in property tax revenue over the previous year.³⁰⁸

If a city adopts a rate exceeding either the voter-approval rate or the de minimis rate, as applicable, it must order an election for the November uniform election date to receive voter approval.³⁰⁹ In some smaller cities, the voters may be able to petition for an election under certain circumstances.³¹⁰

Beyond the mandatory election requirements when cities adopt rates exceeding specific amounts, a home rule city could potentially hold an election on the imposition of a property tax if required to do so by the city charter. The attorney general opined that a court would likely conclude that Chapter 26 of the Tax Code does not conflict with or preempt a city charter provision that requires voter approval before city property taxes may be imposed.³¹¹

Of course, cities are not prohibited from gauging the will of the public when it comes to property taxes or any other issue. A city could conduct a non-binding poll or survey to find out whether the public supports imposition of property taxes. Some cities conduct such polls through inserts in utility bills, for instance.

Finally, it is sometimes asked whether home rule cities with the power of initiative and referendum may have their tax rates challenged by those charter-imposed processes. The answer

³⁰⁶ TEX. TAX CODE § 26.05.

³⁰⁷ TEX. TAX CODE § 26.04(c).

³⁰⁸ TEX. TAX CODE § 26.012 (8-a).

³⁰⁹ TEX. TAX CODE § 26.07.

³¹⁰ TEX. TAX CODE § 26.075.

³¹¹ Tex. Att’y Gen. Op. No. GA-1073 (2014).

is likely not. Texas cases have held that ordinances that rely on careful application of facts and figures are generally not subject to home rule voter initiative or referendum.³¹²

What is the maximum property tax rate a home rule city may adopt?

For all home rule cities, the maximum property tax rate levy is \$2.50 per \$100 of taxable value, although a tax rate lower than \$2.50 may be prescribed by the city charter.³¹³ Interestingly, the sentence in Art. XI, Sec. 5 of the Texas Constitution that sets the maximum tax rate provides as follows: “*Said cities* may levy, assess and collect such taxes as may be authorized by law or by their charters; but no tax for any purpose shall ever be lawful for any one year, which shall exceed two and one-half per cent. of the taxable property of such city... .” (Emphasis added.) The use of the term “said cities” comes after three sentences in the same section, the first of which refers to the ability of cities having more than 5,000 inhabitants being authorized to hold an election to adopt a home rule charter. The next sentence refers to cities that have adopted city charters but fallen below 5,000 inhabitants. As a result, Article XI, Section 5 would likely be construed by a court as authorizing a maximum property tax rate of \$2.50 per \$100 of taxable value for all home rule cities, regardless of population.

What is the maximum property tax rate a general law city may adopt?

The maximum property tax rate for a Type A general law city depends upon the population of the city. Any Type A general law city with fewer than 5,000 inhabitants has a maximum property tax levy of \$1.50 per \$100 of taxable value.³¹⁴ Meanwhile, a Type A general law city with a population of more than 5,000 inhabitants may adopt a maximum tax rate of \$2.50 per \$100 of taxable value.³¹⁵ This is due to the language mentioned above from Article XI, Section 5, which applies the \$2.50 maximum to a city over 5,000 in population that is eligible to hold an election to adopt a home rule charter.

Type B general law cities are limited by state statute to a maximum property tax levy of \$0.25 per \$100 of taxable value.³¹⁶

Type C general law cities’ maximum tax rate is determined by population. A Type C general law city with 201 to 500 inhabitants generally has the same authority as a Type B general law city, unless state statute provides otherwise.³¹⁷ Because a Type B general law city has a maximum tax rate of \$0.25 per \$100 of taxable value, and there is no state law that specifies a maximum tax rate for a Type C general law city, the maximum property tax rate for a Type C general law city that has between 201 and 500 inhabitants is \$0.25 per \$100 of taxable value. Other Type C general law cities may levy a maximum tax rate of \$1.50 per \$100 if the city has fewer than

³¹² *Denman v. Quin*, 116 S.W.2d 783 (Tex. Civ. App.—San Antonio 1938, writ ref’d).

³¹³ TEX. CONST. art. XI, § 5.

³¹⁴ TEX. CONST. art. XI, § 4

³¹⁵ TEX. CONST. art. XI, § 5.

³¹⁶ TEX. TAX CODE § 302.001(b).

³¹⁷ TEX. LOC. GOV’T CODE § 51.051(b).

5,000 inhabitants, and a maximum tax rate of \$2.50 per \$100 if the city has more than 5,000 inhabitants.

Are there special quorum requirements at a meeting to impose property taxes?

Type A general law cities must have two-thirds (essentially four of five) of the council present at a meeting to adopt a property tax.³¹⁸ A home rule city may have special charter requirements relating to quorums. Home rule cities that do not have special charter requirements, and all other general law cities, follow their normal quorum rules when setting a property tax.

When must a property tax be adopted?

The answer depends on whether or not the city is adopting a tax rate exceeding the voter-approval rate. If so, state law requires a city to adopt a property tax rate not later than the 71st day before the November uniform election date.³¹⁹ If the city adopts a tax rate that does not exceed the voter-approval rate, the council must adopt the rate before the later of September 30 or the 60th day after the date the city receives the certified appraisal roll from the chief appraiser.³²⁰

The chief appraiser must deliver the certified appraisal roll to the tax assessor for the city by July 25th of each year.³²¹ However, S.B. 2 gives chief appraisers an alternative to submitting a certified roll to the assessor. S.B. 2 amends the Tax Code to provide that, if the appraisal review board has not approved the appraisal records by July 20th, the chief appraiser shall prepare and certify to the assessor for each taxing unit an *estimate* of the taxable value by not later than July 25th.³²² If a certified estimate is provided instead of a certified appraisal roll, the officer or employee designated by the city council shall calculate the no-new-revenue tax rate and voter-approval tax rate using the certified estimate of taxable value.³²³

Assuming the certified appraisal roll is delivered to the tax assessor by July 25, the city has until “before September 30” to adopt a property tax rate that does not exceed the voter-approval rate. This means that the final day for cities to adopt a tax rate is September 29. The state statute governing city budgets provides that a city council “may levy taxes only in accordance with the budget.”³²⁴ Consequently, a city must adopt its annual budget prior to the adoption of the property tax rate, regardless of whether the rate exceeds the voter-approval rate.

What happens if a city fails to adopt its property tax rate by the deadline?

³¹⁸ TEX. LOC. GOV'T CODE § 22.039.

³¹⁹ TEX. TAX CODE § 26.05(a).

³²⁰ TEX. TAX CODE § 26.05(a).

³²¹ TEX. TAX CODE § 26.01(a).

³²² TEX. TAX CODE § 26.01(a-1).

³²³ TEX. TAX CODE § 26.04(c-2).

³²⁴ TEX. LOC. GOV'T CODE § 102.009(a).

If a city fails to adopt a tax rate exceeding the voter-approval rate by the 71st day before the November uniform election date, then the city loses the ability to adopt a rate exceeding the voter-approval rate. (Note that pursuant to the Texas Election Code, the city must order its election not later than the 78th day before the election date.³²⁵ If the city fails to do so, it also loses the ability to adopt a rate exceeding the voter-approval rate.) The city still could adopt a rate that does not exceed the voter-approval rate by the September 29th deadline. Cities that do not meet the September 29th deadline are nevertheless entitled to a “default” tax rate, which is equal to the lower of the following: (1) the no-new-revenue tax rate for the upcoming year; or (2) last year’s actual tax rate.³²⁶ The city council must pass an ordinance ratifying the default tax rate before the fifth day after the default rate is established. It is important to note that the September 29th deadline does not apply if the appraiser was late in delivering the certified roll to the city. In that case, the city would have 60 days following receipt of the certified roll to adopt its tax rate.³²⁷

Is a city still required to hold two public hearings on the tax rate if the rate exceeds the no-new-revenue rate?

No. Under the law prior to S.B. 2, when a city proposed a tax rate that exceeded the lower of the effective tax rate or the rollback rate, the city generally was required to hold two public hearings prior to adopting the tax rate. Due to the compressed timeframe for adopting a tax rate that exceeds the voter-approval rate, the drafters of S.B. 2 eliminated one of the existing tax rate hearings. Under S.B. 2, a city that adopts a rate exceeding the lower of the no-new-revenue tax rate or the voter-approval tax rate must only hold one public hearing.³²⁸

The lone public hearing under the new law may not be held before the fifth day after the date the notice of the public hearing is given.³²⁹ The city council also may not hold its public hearing or public meeting to adopt a tax rate until the fifth day after the date the chief appraiser of each appraisal district in which the city participates has delivered its tax estimate notice under Tax Code Sec. 26.04(e-2) and made various tax rate information and the tax rate calculation forms available on to the public via the property tax database under Tax Code Sec. 26.17(f).³³⁰ In fact, the city council is prohibited from adopting a tax rate until the chief appraiser has given notice and updated the property tax database.³³¹

There remains an exception to the public hearing requirement if the city proposes and ultimately adopts a tax rate that exceeds the lower of the no-new-revenue rate or voter-approval rate. A “low tax levy” city is defined as a city that proposes a tax rate of 50 cents per \$100 of taxable value or less and has a total tax levy of less than \$500,000.³³² A city that fits this criteria can elect to provide simplified notice authorized by state statute, which also authorizes the city to

³²⁵ TEX. ELEC. CODE § 3.005(c).

³²⁶ TEX. TAX CODE § 26.05(c).

³²⁷ TEX. TAX CODE § 26.05(a).

³²⁸ TEX. TAX CODE § 26.05(d).

³²⁹ TEX. TAX CODE § 26.06(a).

³³⁰ TEX. TAX CODE § 26.05(d-1).

³³¹ TEX. TAX CODE § 26.05(d-2).

³³² TEX. TAX CODE § 26.01(a).

adopt a tax rate that exceeds the lower of the no-new-revenue tax rate or voter-approval rate without a public hearing, so long as it complies with the other statutory requirements in the Tax Code.³³³

Every year in late May or early June, TML publishes detailed property tax and budget procedures and deadlines for both large and small taxing cities. The deadlines vary from year to year because certain statutes prohibit some deadlines from falling on weekends or holidays. A copy of those procedures and deadlines is typically available under the legal section of the TML website, www.tml.org (Legal - Finance/Economic Development - “Budget and Taxation Deadlines”), or can be obtained by calling the TML Legal Department at 512-231-7400.

What is the relationship between property taxes and a city’s budget?

A city may only levy property taxes in accordance with its budget.³³⁴ Put another way, if the budget for the year that coincides with or overlaps the tax year doesn’t show a property tax levy of an approximate amount, property taxes cannot be levied that year.

Further, a budget that will raise more total property taxes than the previous year must be posted on the city’s website (if it operates one), have a special cover page, contain special hearing notices, and requires a separate ratification vote by city council.³³⁵

What are the different types of tax rates?

Following are the different types of tax rates a city must deal with during each tax/budget season:

- (1) **No-New-Revenue Tax Rate (formerly known as the effective tax rate).** The no-new-revenue tax rate is a benchmark tax rate that a city must calculate each year as it begins its property tax and budget process. The no-new-revenue rate is essentially a hypothetical rate that would raise the same amount of property taxes on existing property as last year, after taking into account changes in appraisals.³³⁶

For example, if property values increase by 10 percent over the previous year, the no-new-revenue rate would be 10 percent lower than last year’s nominal (actual) rate, since a lower rate would be sufficient to raise the same amount of total taxes.

The significance of the no-new-revenue rate is that it forms the centerpiece of a concept known as “truth in taxation.” Truth in taxation attempts to focus on whether property taxes go up or down on an individual property, after taking into account appraisal fluctuations. The no-new-revenue rate accomplishes this goal by focusing on raising exactly the same amount of taxes as last year.

³³³ TEX. TAX CODE § 26.052(d).

³³⁴ TEX. LOC. GOV’T CODE § 102.009.

³³⁵ TEX. LOC. GOV’T CODE §§ 102.005(b) & (c), 102.006(c), and 102.007(c).

³³⁶ TEX. TAX CODE § 26.04(c)(1).

The legal effect of the no-new-revenue tax rate is very important. In the first place, a city can always adopt a tax rate equal to (or less than) the no-new-revenue rate without negative consequences. If a city wants to exceed the no-new-revenue rate, however, the city must typically hold a public hearing specifically on the issue of raising taxes.³³⁷ The presiding officer must also use the following language when moving to adopt a tax rate that exceeds the no-new-revenue rate: “I move that property taxes be increased by the adoption of a tax rate of (specify tax rate), which is effectively a (insert percentage by which the proposed tax rate exceeds the no-new-revenue tax rate) percent increase in the tax rate.”³³⁸ Also, detailed published notice must be made of the tax increase hearing.³³⁹

In 2015, legislation passed requiring at least 60 percent of the members of the governing body of a city to vote in favor of an ordinance setting a property tax rate that exceeds the no-new-revenue tax rate.³⁴⁰ Most cities are unaffected by this requirement, because a simple majority in such cities already equates to 60 percent. However, cities with a city council consisting of seven, nine, eleven-plus voting members will need to add one additional councilmember vote to the number needed to adopt a tax rate exceeding the no-new-revenue rate.

The city’s no-new-revenue tax rate should be distinguished from the city’s no-new-revenue maintenance and operations tax rate. As the name suggests, the no-new-revenue maintenance and operations tax rate excludes debt from the calculation.³⁴¹ The no-new-revenue maintenance and operations rate is used to calculate both the voter-approval tax rate and the de minimis tax rate in cities with populations of less than 30,000.

- (2) **Voter-Approval Tax Rate (formerly known as the rollback tax rate).** The voter-approval tax rate is another hypothetical tax rate that is equal to 103.5 percent of the no-new-revenue maintenance and operations rate, plus the debt rate and a new rate called the “unused increment rate.”³⁴² Put another way, it is a rate that would raise precisely 3.5 percent more maintenance and operations taxes as the year before after taking into account appraisal fluctuations.

The significance of the voter-approval tax rate is that if the city adopts a tax rate that exceeds the voter-approval rate, it must—with some exceptions—hold an automatic election to approve the rate on the November uniform election date.

- (3) **Unused Increment Rate.** The unused increment rate is a component of the larger voter-approval rate calculation. The unused increment rate is the 3-year rolling sum

³³⁷ TEX. TAX CODE § 26.05(d).

³³⁸ TEX. TAX CODE § 26.05(b).

³³⁹ TEX. TAX CODE §§ 26.04(e), 26.06(b-1) – (b-3), 26.061, 26.062, and 26.063.

³⁴⁰ TEX. TAX CODE § 26.05(b).

³⁴¹ TEX. TAX CODE § 26.012(18).

³⁴² TEX. TAX CODE § 26.04(c)(2).

of the difference between the adopted tax rate and voter-approval rate.³⁴³ Put differently, the city has the ability to “bank” any unused amounts below the voter-approval rate to use for up to three years. Under no circumstance can the unused increment rate be less than zero.³⁴⁴

The legislature’s stated goal in relation to the unused increment rate is to discourage taxing units from adopting a rate equal to the 3.5 percent voter-approval rate every year. Under the new framework, a city that experiences exceptional growth in sales tax revenues in a year may be able to adopt a rate less than the 3.5 percent voter-approval rate and bank the difference for a future year when sales taxes perform worse than expected. On the other hand, many cities will be forced to go up to the 3.5 voter-approval rate every year just to keep up with rising costs. For those cities, the unused increment rate will be a non-factor.

- (4) **De Minimis Rate.** The de minimis rate is a new tax rate calculation added by S.B. 2 that is designed to give smaller taxing units, including cities, some relief from the 3.5 percent voter-approval tax rate.

The de minimis rate is defined as the sum of:

- A taxing unit’s no-new-revenue maintenance and operations rate;
- The rate that, when applied to a taxing unit’s current total value, will impose an amount of taxes equal to \$500,000; and
- A taxing unit’s current debt rate.³⁴⁵

In a nutshell, the de minimis rate was added to S.B. 2 to allow smaller cities some flexibility to adopt a tax rate that generates \$500,000 more in property tax revenue than the previous year. The thinking was that applying 3.5 percent voter-approval tax rate in some very small communities would unnecessarily restrict revenue growth to sometimes just a nominal amount, and the application of the lowered voter-approval rate created an unfair result for small towns.

If a city with a population of less than 30,000 adopts a tax rate that exceeds the greater of the city’s voter-approval tax rate or the de minimis tax rate, the city council must order an election to approve the adopted tax rate for the November uniform election date.³⁴⁶

But what if a city with a population of less than 30,000 adopts a tax rate that exceeds the voter-approval rate but not the de minimis rate? It is possible, depending on the facts, that the voters would be required to petition for a tax approval election instead of the city being required to hold an automatic election.

³⁴³ See TEX. TAX CODE § 26.013.

³⁴⁴ TEX. TAX CODE § 26.013(b)(1).

³⁴⁵ TEX. TAX CODE § 26.012(8-a).

³⁴⁶ TEX. TAX CODE § 26.07(b).

- (5) **Proposed Tax Rate.** The proposed tax rate is the rate that the city council anticipates adopting while still working through the budget process.
- (6) **Nominal Tax Rate.** The nominal tax rate is the actual tax rate that the city council adopts at the end of the tax and budget process. It is sometimes called the “actual rate” or the “gross rate.”
- (7) **Maintenance and Operations (M&O) Tax Rate.** The M&O rate is a component rate of the nominal tax rate (the debt service rate is the other component) that represents discretionary taxes that are used to fund general operations of the city.
- (8) **Debt Service Tax Rate.** The debt service rate is the second component of the nominal tax rate (the M&O rate is the other) that represents the levy necessary to pay off obligations that are secured by property taxes, such as bonds and certificates of obligation.

What happens if voters don’t approve a city tax rate at a tax rate approval election?

If voters do not approve the city’s adopted tax rate at a tax rate approval election, the city’s rate for the current tax year is set at the voter-approval tax rate.³⁴⁷ If property owners pay their taxes using the originally adopted tax rate and the voters ultimately reject that rate at an election in November, the city must refund the difference between the amount of taxes paid and the amount of taxes due under the voter-approval tax rate.³⁴⁸

The ballot language must allow voting for or against the following proposition: “Approving the ad valorem tax rate of \$_____ per \$100 valuation in (name of taxing unit) for the current year, a rate that is \$_____ higher per \$100 valuation than the voter-approval tax rate of (name of taxing unit), for the purpose of (description of purpose of increase). Last year, the ad valorem tax rate in (name of taxing unit) was \$_____ per \$100 valuation.”³⁴⁹

If property values decline, will a city lose property tax revenue, or be forced to hold a tax rate approval election?

No. The no-new-revenue tax rate, a tax rate that the city must calculate each year, is a helpful mechanism that guarantees a city will never take in fewer taxes than the year before, regardless of what happens to property values (see above). Of course, a city is not required to adopt a rate exceeding the no-new-revenue tax rate. The no-new-revenue tax rate is the rate a city would need to set in order to take in the same dollar amount of taxes as it did the previous year. It will thus be higher or lower than last year’s actual tax rate, in direct correlation to what property values have done in the meantime. A city may always adopt the no-new-revenue rate as its actual rate,

³⁴⁷ TEX. TAX CODE § 26.07(e).

³⁴⁸ TEX. TAX CODE § 26.07(g).

³⁴⁹ TEX. TAX CODE § 26.07(c).

without fear of facing a tax rate approval election. It is a sort of “freebie” rate, in other words, that protects the city against falling property values.

For example, assume that property values in a city have dropped by half since last year (not likely, of course). The no-new-revenue tax rate in such an example would be double the actual tax rate from last year. In other words, the city could legally double the tax rate, since it wouldn’t be taking in any more total taxes than it did the year before.

What property is exempt from property taxes?

State statutes contain numerous types of property that are automatically exempt from property taxes. These include:

- (1) Public property (e.g., city-, county-, and state-owned land used for public purposes);
- (2) Tangible personal property not producing income (see next question regarding optional taxability by a city);
- (3) Family supplies;
- (4) Farm products;
- (5) Implements of husbandry;
- (6) Cemeteries;
- (7) Charitable organizations;
- (8) Charitable hospitals;
- (9) Religious organization property;
- (10) Schools;
- (11) A portion of the assessed value of property owned by a disabled veteran (or the surviving spouse or children of a disabled veteran, under certain circumstances); and
- (12) Qualified property damaged by a disaster.³⁵⁰

What property can be exempted from property taxes (or taxed, if otherwise exempt) at the option of the city?

³⁵⁰ Most property tax exemptions are covered in Chapter 11 of the Texas Tax Code.

Following is a list of exemptions (or optional taxable items) that can be imposed at the option of the city:

- (1) **Optional Homestead Exemption.** A city council has the option of exempting a percentage, not to exceed 20 percent, of the value of residential homesteads for all homeowners in the city.³⁵¹ Such an exemption must be adopted by ordinance or resolution prior to July 1 if it is to apply to a given tax year. Once adopted, the exemption need not be re-adopted every year. The minimum application of the exemption to any property is \$5,000.³⁵² A recent attorney general’s opinion indicates that a city lacks the authority to raise the minimum application “floor” from \$5,000 to \$10,000.³⁵³

The optional homestead exemption for all citizens is for the council only to adopt; it cannot be forced on a city through petition and referendum.

- (2) **Optional Senior and Disabled Exemption.** A city may adopt an optional exemption of a fixed dollar amount of property taxes on the homesteads of persons who are disabled or 65 years of age and older.³⁵⁴ The optional senior and disabled exemption can be adopted in three different ways: (a) the city council can enact the exemption by ordinance or resolution; (b) the city council may call an election of the citizens to adopt the exemption; or (c) the council must call an election if it receives a petition signed by at least 20 percent of the qualified voters who voted in the preceding city election.³⁵⁵

The exemption can be for any amount exceeding \$3000 of the appraised value of the residence homestead. Some cities exempt as much as the first \$100,000 of appraised value of senior and disabled homesteads. More common is \$10,000 or so, and some cities do not grant the exemption at all. The exemption can be reduced, increased, or repealed in subsequent years.³⁵⁶

- (3) **Senior and Disabled Tax Freeze.** See next question.
- (4) **Freeport Tax Exemption.** Certain goods known as “Freeport property” are exempt from property taxation in cities unless the city opted to tax these goods prior to an April 1, 1990, deadline. Most cities opted to continue taxing Freeport property at that time. Such cities may now change their mind, and exempt such property, typically as an economic development incentive. Once a city acts to exempt Freeport property, the decision is final.³⁵⁷

³⁵¹ TEX. TAX CODE § 11.13(n).

³⁵² TEX. TAX CODE § 11.13(n).

³⁵³ Op. Tex. Att’y Gen. No. KP-0215 (2018).

³⁵⁴ TEX. TAX CODE § 11.13(d).

³⁵⁵ TEX. TAX CODE § 11.13(d).

³⁵⁶ TEX. TAX CODE § 11.13(f).

³⁵⁷ TEX. CONST. art. VIII, § 1-j(b).

“Freeport property” includes certain types of tangible personal property that is detained in Texas for assembling, storing, manufacturing, or processing, only to be transported outside the state within 175 days after the property was first acquired in the state.³⁵⁸ In 2013, voters approved a constitutional amendment authorizing a city to take official action to extend the date by which aircraft parts exempted as Freeport goods must be transported outside the state to a date not later than 730 days after the property was first acquired in the state.³⁵⁹

- (5) **Super Freeport Exemption.** Super Freeport goods are similar to Freeport goods, except they need not leave the state. A city may opt out of the exemption at any time, effective the subsequent tax year.³⁶⁰

Freeport property is typically warehouse inventory and manufacturing materials that pass through the state in less than 175 days.³⁶¹

- (6) **Tangible Personal Property not Producing Income.** See subsequent chapter: *Property Tax on Non-Income Producing Tangible Personal Property.*
- (7) **Motor Vehicles Leased for Personal Use.** Motor vehicles leased for personal use are exempt from property taxes.³⁶² Cities had the ability to adopt ordinances before January 1, 2002, to authorize the collection of city property taxes on motor vehicles leased for personal use that would otherwise be exempt from property taxation.³⁶³
- (8) **Historic Site Exemption.** A city council may, by ordinance or resolution, exempt from property taxation part or all of the assessed value of a structure or archeological site and the land necessary for access to and use of the structure or site if the site: (1) is designated as a Recorded Texas Historic Landmark or state archeological landmark by the Texas Historical Commission; or (2) is designated as a historically or archeologically significant site in need of tax relief to encourage its preservation pursuant to an ordinance or resolution adopted by the city council.³⁶⁴ After the exemption is adopted, a city may only repeal or reduce the amount of the exemption for a property qualifying for the exemption if the owner of the property either consents to the repeal or reduction, or the city provides written notice of the repeal or reduction to the owner not later than five years before the date the governing body repeals or reduces the exemption.³⁶⁵
- (9) **Water Conservation Initiative Exemption.** A city council may, by ordinance or resolution, exempt from property taxation part or all of the assessed value of property

³⁵⁸ TEX. CONST. art. VIII, § 1-j(a).

³⁵⁹ TEX. CONST. art. VIII, § 1-j(d).

³⁶⁰ TEX. TAX CODE § 11.253.

³⁶¹ TEX. CONST. art. VIII, § 1-j(a).

³⁶² TEX. TAX CODE § 11.252(a).

³⁶³ TEX. TAX CODE § 11.252(f).

³⁶⁴ TEX. TAX CODE § 11.24(a).

³⁶⁵ TEX. TAX CODE § 11.24(b).

on which approved water conservation initiatives, desalination projects, or brush control initiatives have been implemented.³⁶⁶

- (10) **Temporary Exemption for Qualified Property Damaged by a Disaster.** If the governor first declares territory in a city to be a disaster area on or after the date a city adopts its tax rate for the tax year in which the declaration is issued, the city council may, by official action, adopt an exemption not later than the 60th day after the date the governor first declares territory in the taxing unit to be a disaster area.³⁶⁷ If the governor declares the disaster prior to the city's adoption of the tax rate, then the exemption is automatic.³⁶⁸

What is a property tax freeze?

Tax freezes are a relatively new concept for cities. A 2003 amendment to the Texas Constitution, H.J.R. 16, and an enacting bill, H.B. 136, provided that a city may freeze the homestead taxes of individuals who are disabled or over the age of 65, similar to the current mandatory freeze on school district taxes. For example, if a person over 65 currently pays \$800 in city property taxes, that person will never pay more than that dollar amount during the person's lifetime, or during the lifetime of certain surviving spouses, if the freeze is enacted. The freeze is at the option of the city council, except that an election is required if a petition is received by five percent of the registered voters in the city.³⁶⁹

If we pass a tax freeze, when does it go into effect?

The calendar year during which the tax freeze is adopted by the city essentially becomes the "baseline" year beyond which taxes on the elderly or disabled cannot increase. For example, a city that passes the tax freeze anytime during calendar year 2019 would use the 2020 tax levy as the baseline amount for the freeze. Beginning in tax year 2020, the elderly and disabled would have their city tax bills frozen at the 2019 level, regardless of rate or valuation increases. Put another way, the benefit of the tax freeze does not accrue until the tax year *after* the calendar year in which the freeze is enacted.³⁷⁰

Is there a deadline to pass a city tax freeze?

No. A tax freeze enacted anytime in tax year 2019 is fully effective to freeze tax bills at the 2019 level. TML has been informed of some appraisal districts that are requesting that anticipated tax freeze ordinances be adopted and communicated to the district prior to a certain date in a given

³⁶⁶ TEX. TAX CODE § 11.32.

³⁶⁷ TEX. TAX CODE § 11.35(c).

³⁶⁸ TEX. TAX CODE § 11.35(b).

³⁶⁹ TEX. CONST. art. VIII, § 1-b(h); See also TEX. TAX CODE § 11.261.

³⁷⁰ TEX. TAX CODE § 11.261(b).

year—in June, for example. These requests are likely based on a misunderstanding of the tax freeze legislation, which contains no such deadlines.

If our city passes a tax freeze, can it change its mind later?

No. The legislation is clear that the tax freeze is permanent once enacted.³⁷¹

How does the tax freeze interact with the optional senior tax exemption?

The tax freeze appears to be cumulative of the optional exemption.

For example, if a city currently grants an optional homestead exemption of \$100,000, an elderly resident owning a homestead valued at \$125,000 would currently pay city property taxes on only \$25,000 of value. If the city then adopted a tax freeze, the amount of taxes paid on the homestead would be “frozen” at the amount paid on the \$25,000 of remaining taxable value. Even if the city later cancelled or reduced the \$100,000 optional exemption, the taxes would still be frozen at the amount paid on the \$25,000.

What about persons who aren’t yet 65 when the tax freeze is enacted?

The baseline year for the freeze would be the first tax year in which a person qualifies for an over-65 homestead exemption under state law.

How is the tax freeze treated under Truth-in-Taxation laws?

Taxable value written off due to a tax freeze will be considered lost value for truth-in-taxation purposes, meaning the city will get credit for the lost value in its no-new revenue and voter-approval rate calculations.³⁷²

What happens if a senior enjoying a tax freeze moves to a more expensive home in the same city?

The freeze essentially transfers to the new home, but the taxes owed would increase based on the ratio between the relative values of the old and new homesteads.³⁷³

What happens if a person enjoying a tax freeze moves to a home in a different city?

³⁷¹ TEX. CONST. art. VIII, § 1-b(h).

³⁷² TEX. TAX CODE § 26.012(6)(B).

³⁷³ TEX. TAX CODE § 11.261(g).

Unlike the school district tax freeze, a city tax freeze is not transferable from city to city.

Cities often incur expenses to comply with TCEQ permitting requirements. May a city raise property taxes to compensate without facing a tax rate approval election?

Yes. A city may add to its voter-approval rate those expenditures made during the prior year that were necessary to pay for a facility, device, or method for the control of air, water, or land pollution that was necessary to meet the requirements of a permit.³⁷⁴

May a city require, as a revenue enhancing option, that candidates for mayor or city council not be delinquent in their city property taxes?

Several home rule city charters contain such a requirement, but the enforceability is unclear. The Texas Election Code spells out several eligibility criteria for city officials and authorizes additional requirements by home rule cities, but tax compliance is not mentioned among them. Two federal cases have addressed the situation and come to opposite conclusions. *Gonzales v. Sinton* holds that such a requirement is unconstitutional under federal law.³⁷⁵ However, *Corrigan v. Newago*, another federal case, concludes otherwise.³⁷⁶ Cities should consult with local legal counsel prior to attempting to reject an election applicant on the basis of delinquent taxes.

PROPERTY TAX ON NON-INCOME PRODUCING TANGIBLE PERSONAL PROPERTY

What is the property tax on non-income producing tangible personal property?

Non-income producing tangible personal property—certain luxury goods, for example, that fall outside the household goods exemption—is ordinarily exempt from city property taxes (income-producing tangible property is taxable, however).³⁷⁷

A city may choose to apply its property tax to such goods, however, after following certain procedures.³⁷⁸

³⁷⁴ TEX. TAX CODE § 26.045.

³⁷⁵ *Gonzales v. Sinton*, 319 F. Supp. 189 (1970).

³⁷⁶ *Corrigan v. Newago*, 55 F.3d 1211 (1995).

³⁷⁷ TEX. TAX CODE § 11.14(a).

³⁷⁸ TEX. TAX CODE § 11.14(c).

What is the procedure for applying the city property tax to non-income producing tangible personal property?

The city council must follow these procedures to apply the city property tax to non-income producing tangible personal property:

- (1) **Set Hearing Date.** The city council should schedule a public hearing to address taxation of non-income producing tangible personal property.
- (2) **Newspaper Notice of Hearing.** The city must publish four newspaper notices of the hearing in the city newspaper, in a section other than the advertisements. The first notice must be published at least 31 days prior to the hearing date. The next three notices must appear on different days during the period beginning with the 10th day prior to the hearing and ending with the actual date of the hearing.³⁷⁹
- (3) **Public Hearing.** The city council holds a public hearing at which all interested persons are entitled to speak and present evidence for or against taxing the property.³⁸⁰
- (4) **Finding of Public Interest.** At the conclusion of public testimony at the hearing, the city council, pursuant to a properly noticed agenda item, must make a finding that the council action (taxation of the goods) will be in the public interest of all the residents of the city.³⁸¹
- (5) **Resolution or Order Taxing Goods.** After the hearing and finding above, the council adopts a resolution taxing the otherwise exempt tangible personal property.³⁸²
- (6) **Notify Appraisal District and Tax Collector.**

PRO RATA FEES

What are pro rata fees?

Pro rata fees are fees that result in cost sharing between a city and land owners and/or developers, whereby the city extends its water or sewer mains onto properties or into areas where it is not otherwise the duty of the city to do so, or improves water and sewer mains where it is not otherwise obligated to do so. Certain types of these fees are sometimes called “extension of the main” fees.

³⁷⁹ TEX. TAX CODE § 11.14(e).

³⁸⁰ TEX. TAX CODE § 11.14(e).

³⁸¹ TEX. TAX CODE § 11.14(e).

³⁸² TEX. TAX CODE § 11.14(c).

There are numerous variations of pro rata fees agreed upon by cities and developers or landowners. Sometimes the developer is asked to pay all the costs of lines or facilities up front, and the city reimburses the developer a portion of the costs after the land is occupied and other customers tie on to the main. Sometimes the opposite occurs, and the developer or final tenants reimburse the city a portion of the costs that the city fronted for the new main. Sometimes the developer pays for the entire extension, while the city pays the relative costs of a larger than normal main to accommodate special development.

How are pro rata fees imposed?

Other than their relationship to impact fees, pro rata fees are seldom mentioned in state statutes. A city need not find explicit authority to enact them because they aren't really fees in the usual, coercive sense of the word. Rather, they are simply an agreed-to contractual relationship where one party to development improves water or sewer lines beyond what is required by law and is reimbursed by the other party.

What is the relationship between pro rata fees and impact fees?

The impact fee statute, Chapter 395 of the Local Government Code, specifically excludes pro rata fees for reimbursement of water or sewer mains or lines extended by the political subdivision from the statutory definition of "impact fees."³⁸³ As a result, cities may impose water and sewer pro rata fees without complying with the complicated and tedious procedures of the impact fee statute.

Exclusion of water and sewer pro rata fees from the impact fee statute has a potential downside legally. Some city attorneys argue that because only water and sewer pro rata fees are excluded from the definition of an impact fee, other attempts at pro rata fees—roadway escrow fees, for example—are not legally authorized unless the impact fee statute is complied with. Cities attempting to share costs for any infrastructure other than water and sewer should consult their city attorney.

RAFFLES

What is a raffle?

A raffle is the awarding of one or more prizes by chance at a single occasion among a single group of people who have paid or promised a thing of value for a ticket that represents a chance for a person to win a prize.³⁸⁴

³⁸³ TEX. LOC. GOV'T CODE § 395.001(4)(D).

³⁸⁴ TEX. OCC. CODE § 2002.002(6).

May a city conduct a raffle?

No. Only certain organizations are authorized under statute to hold a charitable raffle. A qualified nonprofit organization “that has existed for at least three preceding years and is exempt from federal income tax under Section 501(c), Internal Revenue Code; does not distribute any of its income to its members, officers or governing body; does not devote a substantial part of its activities to attempting to influence legislation; and does not participate in any political campaign” may hold a raffle.³⁸⁵

Additionally, a qualified volunteer fire department or emergency medical service provider may hold a charitable raffle.³⁸⁶ To be considered a qualified volunteer fire department or emergency medical service provider, the organization must: (1) be organized primarily to provide and actively provide emergency medical, rescue, ambulance, or fire service services; (2) not pay its members compensation other than nominal compensation; and (3) not distribute any of its income to its members, officers, or governing body other than for reimbursement of expenses.

May a volunteer fire department or volunteer emergency service provider provide a cash prize?

No. State law prohibits the use of money as a prize for a raffle.³⁸⁷ Money is defined as “coins, paper currency, or a negotiable instrument that represents and is readily convertible to coins or paper currency.”³⁸⁸

RIGHT-OF-WAY RENTAL FEES

What are right-of-way rental fees?

“Right-of-way rental fees,” also called “franchise fees,” are the rental costs paid by utilities that use the city’s rights-of-way or other city property to transmit their services. Rights of way, just like other land interests, are valuable to a city and cannot be given away to private companies free of charge.³⁸⁹

How are right-of-way rental fees calculated?

When the practice of franchising and receiving right-of-way compensation began, most fees were calculated by cities like any rental of rights-of-way would be, typically on a cost per linear

³⁸⁵ TEX. OCC. CODE § 2002.003.

³⁸⁶ TEX. OCC. CODE § 2002.002.

³⁸⁷ TEX. OCC. CODE § 2002.056.

³⁸⁸ Op. Tex. Att’y Gen. No. GA-0341 (2005).

³⁸⁹ TEX. CONST. art. III, § 52.

foot of right of way or per pole methodology. Soon, that practice was replaced with one based on a gross receipts basis, which more accurately reflects the value of the use of the right of way to the utility occupying it. The gross receipts methodology was codified by federal law for cable television providers, and by state law for gas, electric, and water utilities.

Since the mid-1990s, however, telecommunications, electric, and cable/video industries have successfully lobbied for legislation that ties their right-of-way rental fees to other statutory formulas or methodologies. At present, electric, telecommunication, gas, water, cable television, and video service providers each have their own legal framework with regard to how the fee is calculated and assessed.

RIGHT-OF-WAY RENTAL FEES ON CABLE TELEVISION AND OTHER VIDEO SERVICES

Are cities entitled to compensation for use of rights-of-way by cable and other video services providers?

Yes, although legislation passed in 2019 could limit right-of-way rental fees for cable paid by a company providing both cable and telecommunications services. For many years, cable companies were the sole provider of wire-based video programming to city residents. Until 2005, a cable company that wanted to serve customers within a Texas city did so by obtaining a local franchise agreement from that city. Federal law requires a local authority (e.g., a state or local government) to issue a franchise agreement, and Texas law provides for compensation for the use of a city's rights-of-way.

In 2005, the legislature passed Senate Bill 5, which created a new Chapter 66 of the Texas Utilities Code. Chapter 66 has several provisions, some of which are complex. Essentially, the law:

1. creates a state-issued cable and video franchise (known as a state-issued certificate of franchise authority or SICFA) to be administered by the Public Utility Commission (PUC);³⁹⁰
2. requires the holder of the SICFA to make a quarterly franchise payment to each city in which it provides service and that the payment be equal to five percent of gross revenues, as that term is defined in the law, earned by the franchise holder in that city;³⁹¹ and
3. requires the holder of a SICFA to pay each city a public, educational, and government (PEG) channel support fee an amount equal to one percent of the provider's gross

³⁹⁰ TEX. UTIL. CODE § 66.003.

³⁹¹ TEX. UTIL. CODE § 66.005.

revenue or, at the city's election, the per-subscriber line fee that was paid under previous franchise agreements.³⁹²

Every Texas city should now be compensated pursuant to a SIFCA from each provider. However, due to recent legislation, cities might not receive right-of-way rental fees from certain providers in a given year. In 2019, the legislature passed S.B. 1152, which authorizes a “bundled” cable and telecommunications provider to stop paying the lesser of its state cable right-of-way rental fees or telephone access line fees, whichever is less for the company statewide.³⁹³ By October 1st of each year, the provider must file a written notification with each city of which fee will be eliminated.³⁹⁴

How must the fees be spent?

The quarterly five-percent franchise fee can be spent in any manner a city council chooses. However, state law imposes limitations on the use of and accounting related to the one-percent PEG fee. Under Chapter 66, the PEG fee is paid quarterly in the same manner as the five percent franchise fee. The law requires:

1. the holder of a SICFA to specifically identify the amount of the PEG fee when it is paid;³⁹⁵ and
2. a city to: (a) establish a separate account for the PEG fee revenue; and (b) maintain “a record of each deposit to and disbursement from [the PEG fee] the separate account, including a record of the payee and purpose of each disbursement.”³⁹⁶

Note that a city must have only one separate PEG fee account, not necessarily a separate account for each provider in the city. It is advisable that a city keep the PEG fee account entirely separate from its general fund to comply with the law, which states that the city “may not comingle” PEG fees “with any other money.”³⁹⁷

What if my city has no PEG channels and doesn't anticipate having any in the near future?

Under Chapter 66, a PEG fee may be spent only as permitted by federal law.³⁹⁸ Federal law provides that the fee must be used for “capital costs for PEG facilities.”³⁹⁹ This means that a city may not spend PEG fee revenue on general expenditures or PEG channel operational or other, non-capital costs. Some cities may not have enough PEG fee revenue now—or in the foreseeable future—to operate a PEG channel. Other cities may not desire to operate a PEG channel. Cities in either situation may choose to accumulate the PEG fee revenue in anticipation of spending it

³⁹² TEX. UTIL. CODE § 66.006.

³⁹³ TEX. UTIL. CODE § 66.005(d).

³⁹⁴ TEX. UTIL. CODE § 66.005(f)

³⁹⁵ TEX. UTIL. CODE § 66.006(c-1).

³⁹⁶ TEX. UTIL. CODE § 66.006(c-2).

³⁹⁷ TEX. UTIL. CODE § 66.006(c-2)(2).

³⁹⁸ TEX. UTIL. CODE § 66.006(c).

³⁹⁹ 47 U.S.C. § 521, *et seq.* (Federal Cable Law).

on allowable expenditures in the future, or may choose to “opt out” of the PEG fee by resolution or ordinance. Any city considering “opting out” of the PEG fee should consult with legal counsel on the matter prior to taking any action.

RIGHT-OF-WAY RENTAL FEES ON ELECTRICITY

May cities charge for the use of rights-of-way by electric utilities?

Yes. Prior to 1999, electric right-of-way rental fees were calculated in much the same way that water and gas franchise fees were calculated (based on gross receipts). In 1999, the electric restructuring bill, S.B. 7, altered the right-of-way rental fee methodology for electric providers. Under S.B. 7, cities retain the right to manage public rights-of-way and to collect compensation for use of rights-of-way and public property for the delivery of electric service, albeit under a different compensation methodology.

How are electric right-of-way rental fees calculated?

Compensation for use of rights-of-way and city land by electric providers is based on kilowatt hours of electricity delivered within the city. The rate per kilowatt hour is based on the amount of compensation that the city received in calendar year 1998 for its then-existing electric right-of-way rental fee, divided by the number of kilowatt hours delivered to retail customers in the city during 1998. In other words, 1998 is a “baseline” year from which cities calculate future fees based on usage. As electric consumption grows within the city, so will the total amount of compensation.⁴⁰⁰ (Note: Some cities may still collect a gross receipts franchise fee from electric cooperatives and municipal electric utilities.⁴⁰¹)

Are per kilowatt right-of-way rental fees automatically due the city?

No, the statute provides that a city is “entitled to collect” the fees, but does not provide for automatic payment by the electric utility.⁴⁰² A city should adopt an electric franchise ordinance providing for collection of the fees to which it is entitled. Copies of sample electric right-of-way rental fee ordinances can be obtained from the TML Legal Department at 512-231-7400.

What about franchise agreements providing for different fees that are already in effect?

⁴⁰⁰ TEX. UTIL. CODE § 33.008(b).

⁴⁰¹ TEX. UTIL. CODE § 33.008(f).

⁴⁰² TEX. UTIL. CODE § 33.008(b).

Generally, the per kilowatt hour methodology of right-of-way rental fees replace any franchise agreement fee provision in effect prior to January 1, 2002.⁴⁰³

What about existing franchise agreement provisions relating to matters other than fees?

Provisions in franchise agreements in existence as of January 1, 2002, that are not related to fees continue in effect after the new per kilowatt hour methodology of SB 7.⁴⁰⁴

What about cities that are newly incorporated since the 1998 base year?

Cities that are recently incorporated, or cities that have not previously collected electric right-of-way rental fees, may adopt a franchise ordinance that collects fees at the same per kilowatt hour rate that is collected by any other city in the same county that is served by the same electric utility.⁴⁰⁵

May cities collect right-of-way rental fees by any methodology other than per kilowatt hour?

If a city had a franchise agreement in effect as of September 1, 1999, at the expiration of that agreement the city and the electric utility could agree to a different franchise fee methodology.⁴⁰⁶ If such a rate methodology is not negotiated at that time, the per kilowatt hour methodology goes into effect.

How can a city make sure it is receiving all the electric franchise fees it is entitled to?

A city collecting per kilowatt hour right-of-way rental fees may audit an electric utility concerning any payment made within the past two years prior to the start of the audit.⁴⁰⁷

RIGHT-OF-WAY RENTAL FEES ON GAS AND WATER

May cities charge for the use of rights-of-way by gas and water utilities?

Yes, Section 182.025 (a) and (b) of the Texas Tax Code provide that:

⁴⁰³ TEX. UTIL. CODE § 33.008(d).

⁴⁰⁴ TEX. UTIL. CODE § 33.008(d).

⁴⁰⁵ TEX. UTIL. CODE § 33.008(g).

⁴⁰⁶ TEX. UTIL. CODE § 33.008(f).

⁴⁰⁷ TEX. UTIL. CODE § 33.008(e).

(a) An incorporated city or town may make a reasonable lawful charge for the use of a city street, alley, or public way by a public utility in the course of its business.

(b) The total charges, however designated or measured, may not exceed two percent of the gross receipts of the public utility for the sale of gas or water within the city.

These sections are the original right-of-way rental fee statutes that applied to more than just gas and water franchises. Since these sections were adopted, other franchises—electric, telecommunications, and so on—have adopted more specialized rate methodologies. The result is that by default the Tax Code provisions now apply just to water and gas.

So, the maximum that can be charged for gas or water right-of-way rental fees is two percent of gross receipts, right?

Not necessarily. While Section 182.025(b) of the Tax Code seems to limit the total amount of a unilaterally-imposed gas or water right-of-way rental fee to two percent, the next section of the Tax Code provides as follows:

Section 182.026(b)(2):

(b) This subchapter does not...

(2) impair or alter a provision of a contract, agreement, or franchise made between a city and a public utility company relating to a payment made to the city.

These provisions taken together are normally interpreted to mean that while a city may unilaterally impose a two-percent right-of-way rental fee on a gas or water provider, the fee may be at a greater rate if the parties agree in writing.

Assuming the gas or water utility is willing to pay right-of-way rental fees, does the utility have an absolute right to use the rights-of-way?

No. Cities may choose to grant franchises as they see fit.⁴⁰⁸ Gas companies do have a right to cross under city streets, however, subject to direction by the city.⁴⁰⁹

RIGHT-OF-WAY RENTAL FEES ON SMALL CELL NODES

⁴⁰⁸ TEX. NAT. RES. CODE § 111.022; TEX. UTIL. CODE § 103.002.

⁴⁰⁹ TEX. UTIL. CODE § § 181.005 and 181.006.

What is a small cell node?

A small cell node is simply an antenna and related equipment that is placed on a pole (either a city pole such as a traffic signal or light pole or a stand-alone pole) that is generally shorter than 55 feet tall. Small cell nodes are not yet a replacement for the large “macro towers” that dot our landscape. Rather, the nodes are meant to expand network bandwidth in densely populated areas. S.B. 1004, which enacted Chapter 284 of the Texas Local Government Code in 2017, allows cell companies and others to place the nodes in city rights-of-way and on most types of city-owned poles.

May cities charge for the use of rights-of-way for small cell nodes?

Yes, a city can charge a maximum annual amount equal to \$250 multiplied by the number of network nodes installed in the public right-of-way in the city’s corporate boundaries.⁴¹⁰ A city may adjust the amount of the public right-of-way rate not more often than annually by an amount equal to one-half the annual change, if any, in the consumer price index.⁴¹¹ (A cell company may also have to pay additional fees for “transport service” to connect a node to the network using fiber.⁴¹²)

Assuming the cell company is willing to pay right-of-way rental fees, does it have an absolute right to use the rights-of-way?

Probably, although the law grants some control to cities by allowing them to, among other things:

1. Adopt a “design manual,” which can include things like aesthetics, insurance, and recommended placement locations⁴¹³;
2. Create an “attachment agreement” governing how nodes are attached to city facilities⁴¹⁴; and
3. Create “design districts” that can have more stringent aesthetic requirements.⁴¹⁵

Most cities will also need to review their right-of-way management ordinance and may need to create or modify permit application forms for right-of-way access. The documents can be very simple or very complex, depending on the needs of each city.

Is the maximum amount a city can charge constitutional?

⁴¹⁰ TEX. LOCAL GOV’T CODE § 284.053.

⁴¹¹ TEX. LOCAL GOV’T CODE § 284.054.

⁴¹² TEX. LOCAL GOV’T CODE § 284.055.

⁴¹³ TEX. LOCAL GOV’T CODE § 284.108.

⁴¹⁴ TEX. LOCAL GOV’T CODE § 284.201.

⁴¹⁵ TEX. LOCAL GOV’T CODE § 284.105.

Several cities are arguing in court that it is not. The City of McAllen is leading a coalition of around twenty cities that has filed a lawsuit to challenge the unconstitutionally low right-of-way rental fees in Chapter 284. The coalition claims that the price per node in law is a taxpayer subsidy to the cellular industry because it allows nearly free use of taxpayer-owned rights-of-way and facilities. Both lawsuits were still pending in district court as of the time of printing.

RIGHT-OF-WAY RENTAL FEES ON TELEPHONE (TELECOMMUNICATIONS) SERVICE

May cities charge for the use of rights-of-way by telephone companies?

Yes, cities may charge telecommunications right-of-way rental fees. However, S.B. 1152 from 2019 could limit right-of-way rental fees for cable paid by a company providing both cable and telecommunications services. Similar to franchise fees on electric service, the state law regarding methodology of telecommunications franchise fees changed dramatically in 1999. That year, H.B. 1777 was enacted and created Chapter 283 of the Texas Local Government Code. Chapter 283 addresses city authority over its rights-of-way generally, and also establishes a formula for calculating right-of-way rental fees (called “access line fees” in the law).

How are right-of-way rental fees on telecommunications calculated?

Cities are entitled to a rate equal to the number of “access lines” (roughly speaking, end use local exchange lines within the city) currently located within the city multiplied by the access line fee rate calculated for each city based on the franchise fee revenues received by the city in 1998. In other words, 1998 is the “baseline” year for determining the rate, and the total revenue is that rate multiplied by the current number of access lines.⁴¹⁶ Added to this compensation is one-half of the annual change, if any, in the consumer price index.⁴¹⁷

S.B. 1152, passed in 2019, allows a “bundled” cable and telecommunications provider to stop paying the lesser of its state cable right-of-way rental fees or telephone access line fees, whichever is less for the company statewide.⁴¹⁸ By October 1 of each year, the provider must file a written notification with each city of which fee will be eliminated.⁴¹⁹

How are pre-existing telecommunications right-of-way rental fee ordinances treated?

⁴¹⁶ TEX. LOC. GOV'T CODE § 283.055(f).

⁴¹⁷ TEX. LOC. GOV'T CODE § 283.055(g).

⁴¹⁸ TEX. LOC. GOV'T CODE § 283.051(d).

⁴¹⁹ TEX. LOC. GOV'T CODE § 283.051(f).

Right-of-way rental fee ordinances executed prior to January 12, 1999, continue in effect unless the provider company elected to terminate the agreement prior to December 1, 1999.⁴²⁰ After termination of a pre-existing franchise fee ordinance, either through its terms or upon termination by the provider, the access line provisions of H.B. 1777 begin to apply for calculating franchise fees.⁴²¹

What about cities that did not have telecommunications right-of-way rental fees as of 1999?

Such a municipality shall follow the same general access line methodology as other cities, but in determining the base amount for rate calculations the city may elect from the following: (1) the statewide average paid by the city's incumbent provider; or (2) the amount a similarly-sized city served by the same provider in the county or an adjacent county was receiving.⁴²²

What about right-of-way rental fees on cell phones and satellite service?

Remember, right-of-way rental fees exist to reimburse the city for use of the rights-of-way by a utility's cables, pipes, and other facilities. To the extent that cell phone usage or satellite service dispenses with physical facilities, no right-of-way rental fees are due.

SALES TAX FOR CRIME CONTROL

What is the sales tax for crime control?

The sales tax for crime control is an optional, dedicated city sales tax that is levied within a crime control and prevention district (a "district"), and may be spent on certain law enforcement projects within the district.

Which cities are eligible to adopt a sales tax for crime control?

Any city that is located partially or wholly in a county with a population of 5,000 or more may adopt the tax.⁴²³

Where is a sales tax for crime control levied within a city?

⁴²⁰ TEX. LOC. GOV'T CODE § 283.054(a).

⁴²¹ TEX. LOC. GOV'T CODE § 283.054(a).

⁴²² TEX. LOC. GOV'T CODE § 283.053.

⁴²³ TEX. LOC. GOV'T CODE § 363.051(a).

The tax is levied only within the boundaries of a crime control and prevention district.⁴²⁴ A district may consist of all or a part of the corporate boundaries of a city that creates it.⁴²⁵ In other words, the tax need not be levied across the entire corporate jurisdiction of the city, which may be useful to accommodate areas of a city that are “capped out” at the two-percent maximum local sales tax. Legislation passed in 2015 that authorizes a city council in a city that has a crime control and prevention district to call an election to add all or part of the territory within the city to the district and allows for the imposition of the sales tax in the new territory.⁴²⁶

How much sales tax for crime control may be levied?

The rate of a sales tax for crime control may be any rate that is an increment of one-eighth of one percent that the city determines is appropriate.⁴²⁷ However, the total combined tax rate within the city may not exceed two percent.⁴²⁸

What may a sales tax for crime control be spent on?

Revenues from the sales tax for crime control may be spent to fund the following projects:

a multi-jurisdiction crime analysis center; mobilized crime analysis units; countywide crime stoppers telephone lines; united property-marking programs; home security inspection programs; an automated fingerprint analysis center; an enhanced radio dispatch center; a computerized criminal history system; enhanced information systems programs; a drug and chemical disposal center; a county crime lab or medical examiner's lab; a regional law enforcement training center; block watch programs; a community crime resistance program; school-police programs; senior citizen community safety programs; senior citizen anticrime networks; citizen crime-reporting projects; home alert programs; a police-community cooperation program; a radio alert program; ride along programs; positive peer group interaction programs; drug and alcohol awareness programs; countywide family violence centers; work incentive programs; social learning centers; transitional aid centers and pre-parole centers; guided group interaction programs; social development centers; street gang intervention centers; pre-delinquency intervention centers; school relations bureaus; integrated community education systems; steered straight programs; probation subsidy programs; Juvenile Offenders Learn Truth (JOLT) programs; reformatory visitation programs; juvenile awareness programs; shock incarceration; shock probation; community restitution programs; team probation; electronic monitoring programs; community improvement programs; at-home arrest; victim restitution programs; additional probation officers; additional parole officers; court watch programs; community

⁴²⁴ TEX. LOC. GOV'T CODE § 363.054(b)(6).

⁴²⁵ TEX. LOC. GOV'T CODE § 363.051(b).

⁴²⁶ TEX. LOC. GOV'T CODE § 363.181.

⁴²⁷ TEX. LOC. GOV'T CODE § 363.055(a).

⁴²⁸ TEX. LOC. GOV'T CODE § 363.055(a) and TEX. TAX CODE § 321.101(f).

arbitration and mediation centers; night prosecutors programs; automated legal research systems; an automated court management system; a criminal court administrator; an automated court reporting system; additional district courts that are required by law to give preference to criminal cases, judges, and staff; additional prosecutors and staff; and additional jails, jailers, guards, and other necessary staff.⁴²⁹

What is the city's role in spending the sales tax for crime control?

Revenues from the tax are spent by the board of directors of the district, not the city council itself.⁴³⁰ The seven-member board is appointed by the city council, however.⁴³¹

How is the sales tax for crime control adopted?

Like all city sales taxes, a sales tax for crime control must be adopted at an election of the voters.⁴³² Technically, the temporary directors of a district order the election, but the city council alone is authorized to form the district and appoint the temporary directors.⁴³³

SALES TAXES FOR DEDICATED PURPOSES

What are sales taxes for dedicated purposes?

This manual refers to all city sales taxes, other than the sales tax for general revenue, as sales taxes for dedicated purposes. Each tax other than the sales tax for general revenue 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. A city could even have dedicated sales taxes in the absence of a general revenue sales tax, but no city is known to do so currently.

How many different sales taxes, including the sales tax for general revenue, may our city adopt?

There is no express limitation, so long as all local sales taxes combined must total no more than two percent at a given location. Because counties and special districts sometimes adopt local

⁴²⁹ TEX. LOC. GOV'T CODE § 363.151.

⁴³⁰ TEX. LOC. GOV'T CODE § 363.154(e).

⁴³¹ TEX. LOC. GOV'T CODE § 363.101(a).

⁴³² TEX. LOC. GOV'T CODE § 363.053.

⁴³³ TEX. LOC. GOV'T CODE §§ 363.051(a) and 363.054(a).

sales taxes, and because all such taxes count against the two-percent cap, a city might have less than two percent available for its own general revenue and dedicated sales taxes.

In 2015, important legislation passed in the form of H.B. 157, which gives cities increased flexibility to reallocate the amounts of its general revenue and dedicated sales taxes within the two-percent cap. 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.⁴³⁴

If a city is “maxed out” at the two-percent sales tax cap, can the city switch from one dedicated sales tax to another using one ballot proposition?

Yes. Legislation that passed in 2005 permits a city to repeal or lower one dedicated sales tax, and raise or adopt a different dedicated sales tax, all with one combined ballot proposition.⁴³⁵ 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.

How do we word a combined sales tax ballot proposition?

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.⁴³⁶ To make sure that the city properly words its ballot proposition, local legal counsel should be consulted. The TML Legal Department (512-231-7400, legalinfo@tml.org) can provide samples of such combined propositions.

May the city’s dedicated sales taxes be pledged to pay off bonds?

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

⁴³⁴ TEX. TAX CODE § 321.406.

⁴³⁵ TEX. TAX CODE § 321.409.

⁴³⁶ TEX. TAX CODE § 321.409(b).

SALES TAX FOR ECONOMIC DEVELOPMENT

What is the sales tax for economic development?

The sales tax for economic development is an optional, dedicated city sales tax that is used to attract and retain business within the city. There are two types of sales taxes for economic development, a Type A and a Type B tax. These are formerly known as “4A” and “4B” taxes, named for their respective locations within the Development Corporation Act of 1979. The laws regarding Type A and Type B economic development corporations are now codified in the Local Government Code.

What cities may adopt a sales tax for economic development?

Almost any Texas city, provided it has room under its two-percent local sales tax cap, can adopt one or the other (or both) of the Type A or Type B sales taxes. Any city located in a county with a population of less than 500,000 may adopt a Type A sales tax, as well as a few cities in larger counties.⁴³⁷ All cities with room under the cap are eligible to adopt a Type B sales tax.⁴³⁸

How is a sales tax for economic development adopted?

Like all sales taxes, the sales tax for economic development is adopted by vote of the citizens at an election. A Type A or Type B election may be called by the city council on its own motion or on petition of 20 percent of the voters who voted in the most recent city election.⁴³⁹

How much economic development sales tax may a city levy?

The rate of a sales tax for economic development may be any rate that is an increment of one-eighth of one percent that the city determines is appropriate.⁴⁴⁰ The combined rate of all local sales taxes within the city, however, cannot exceed two percent.⁴⁴¹ A city could adopt either or both of the Type A and Type B sales taxes for economic development if it has room under the cap.

⁴³⁷ TEX. LOC. GOV'T CODE § 504.002.

⁴³⁸ TEX. LOC. GOV'T CODE § 505.002.

⁴³⁹ TEX. LOC. GOV'T CODE §§ 504.255(a) and 505.251.

⁴⁴⁰ TEX. LOC. GOV'T CODE §§ 504.252(b) and 505.252(b).

⁴⁴¹ TEX. LOC. GOV'T CODE §§ 504.254(a) and 505.256.

Is it true that economic development sales taxes are not useful for direct incentives to retail and commercial businesses?

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 Type A and Type B sales tax corporations to give direct incentives to retail businesses. Legislation passed in 2005 restored retail authority for Type B corporations (but not Type A 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 Type B sales tax revenue for each of the prior two years.⁴⁴² Also, certain corporations located near Mexico, and certain “landlocked” cities in large urban areas, are once again eligible to promote retail business.

What may sales taxes for economic development be spent on?

Generally speaking, both the Type A and Type B sales tax for economic development may be spent on development projects and incentives that create “primary jobs.”⁴⁴³ Primary jobs are defined to include jobs in crop production, animal production, forestry and logging, fishing, mining, utilities, manufacturing, wholesale trade, transportation and warehousing, financial-related industry, scientific research and development, corporate management, and prisons.⁴⁴⁴

Both the Type A and Type B sales taxes may also be spent to promote the city, provided no more than ten percent of the tax is used for promotional purposes.⁴⁴⁵

Both taxes may also be spent on certain infrastructure that benefits any new or expanded business, provided the infrastructure consists of streets, roads, rail spurs, water and electric utilities, gas utilities, drainage and related improvements, and telecommunications and Internet improvements.⁴⁴⁶

Type B sales taxes for economic development (but not Type A) may be spent on: (1) sports stadiums⁴⁴⁷ (Type A taxes may be spent on stadiums only after an election⁴⁴⁸); (2) entertainment and convention facilities⁴⁴⁹; (3) city parks⁴⁵⁰; (4) affordable housing⁴⁵¹; and (5) for cities with less than 20,000 population or less than \$50,000 in Type B sales tax revenues for each of the prior two years, commercial and retail economic development incentives.⁴⁵²

⁴⁴² TEX. LOC. GOV'T CODE §§ 505.156 and 505.158(a).

⁴⁴³ TEX. LOC. GOV'T CODE § 501.001.

⁴⁴⁴ TEX. LOC. GOV'T CODE § 501.002(12).

⁴⁴⁵ TEX. LOC. GOV'T CODE §§ 504.105 and 505.103.

⁴⁴⁶ TEX. LOC. GOV'T CODE § 501.103.

⁴⁴⁷ TEX. LOC. GOV'T CODE § 505.152.

⁴⁴⁸ TEX. LOC. GOV'T CODE § 504.152.

⁴⁴⁹ TEX. LOC. GOV'T CODE § 505.152.

⁴⁵⁰ TEX. LOC. GOV'T CODE § 505.152.

⁴⁵¹ TEX. LOC. GOV'T CODE § 505.153.

⁴⁵² TEX. LOC. GOV'T CODE §§ 505.156 and 505.158(a).

What is the city’s role in expending the proceeds of the sales taxes for economic development?

The city itself does not expend sales tax proceeds. Instead, the city creates an economic development corporation that is governed by a board of directors. The board of the economic development corporation is responsible for deciding how to spend the proceeds of the sales tax for economic development. The city council must approve each expenditure, however, hence the city has a sort of “veto” power over the corporation.⁴⁵³

SALES TAX FOR GENERAL REVENUE

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 goods sold in the city. The revenues from the tax may be spent on almost any lawful purpose of the city.

How much general revenue sales tax may be levied by 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. House Bill 157, passed in 2015, authorizes a city 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.⁴⁵⁴ 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.

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. Examples of additional sales taxes for dedicated purposes include economic development, property tax relief, crime control, and street maintenance. Each of these additional, dedicated sales taxes is outlined in separate chapters in this manual. See chapter: *Sales Taxes for Dedicated Purposes*.

How does a city adopt a sales tax for general revenue?

⁴⁵³ TEX. LOC. GOV’T CODE § 501.073.

⁴⁵⁴ TEX. TAX CODE § 321.103(a).

The sales tax for general revenue is adopted by an election of the city voters.⁴⁵⁵ 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 members⁴⁵⁶; 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.⁴⁵⁷

A sales tax for general revenue election must be held on the first uniform election date that occurs after the tax election is called for by ordinance or petition.⁴⁵⁸ Specific ballot language is required by statute.⁴⁵⁹

If a city is “maxed out” at the two-percent sales tax cap, can the city reduce or repeal one dedicated sales tax and increase the general revenue sales tax by the same amount using one ballot proposition?

Yes. Legislation that passed in 2005 permitted a city to repeal or lower one dedicated sales tax, and raise or adopt a different dedicated sales tax, all with one combined ballot proposition.⁴⁶⁰ At the time, the combined ballot proposition only applied to dedicated sales taxes because the general revenue sales tax, if adopted by a city, was fixed at one percent. Following the passage of H.B. 157 in 2015, a city could hold an election to increase or decrease its general revenue sales tax in any increment of one-eighth of one percent, as mentioned above. In 2017, the combined ballot proposition statute was amended to apply to all city sales taxes, which would include the general revenue sales tax.⁴⁶¹ Now a city can use a combined ballot proposition at an election to adjust the rates of any dedicated city sales tax or the city’s general revenue sales tax.

How is the sales tax for general revenue collected?

All city sales taxes, including the sales tax for general revenue, are collected by the Texas Comptroller, along with the state sales tax.⁴⁶² The comptroller then remits the city its portion of the taxes at least twice a year (though it is done more often in practice).⁴⁶³

The comptroller keeps two percent of city sales taxes as payment for the state’s services in collecting the tax.⁴⁶⁴ Cities can independently sue businesses to collect unpaid taxes, but in practice this almost never happens because the state, when suing for its own taxes, customarily sues on behalf of the city as well.

⁴⁵⁵ TEX. TAX CODE § 321.101(a).

⁴⁵⁶ TEX. TAX CODE § 321.401(a) and (b).

⁴⁵⁷ TEX. TAX CODE § 321.101(c).

⁴⁵⁸ TEX. TAX CODE § 321.403.

⁴⁵⁹ TEX. TAX CODE § 321.404.

⁴⁶⁰ TEX. TAX CODE § 321.409.

⁴⁶¹ House Bill 3046, 85th Legislature, Regular Session (2017).

⁴⁶² TEX. TAX CODE § 321.301.

⁴⁶³ TEX. TAX CODE § 321.502.

⁴⁶⁴ TEX. TAX CODE § 321.503.

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

Generally not.⁴⁶⁵ Excepted from this prohibition, however, are certain sports and community venue projects.⁴⁶⁶

We aren't sure that our city is receiving all the sales taxes it is due from the comptroller. For instance, there is a business on the edge of town with an out-of-town address. We don't think it is collecting city sales taxes. What can we do?

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 the 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.

Legislation was passed in 2011 that provides some limited authority for a city to receive information used by the comptroller in making a reallocation determination. If city sales tax revenue is refunded or reallocated from one city to another, a city is now authorized to receive from the comptroller all sales tax returns and reports (whether confidential or not) filed by not more than five individual taxpayers in the city, if the amount of the reallocation exceeds: (a) \$200,000; (b) ten percent of the revenue received by the city during the previous calendar year; or (c) an amount that increases or decreases the amount of revenue the city receives during a calendar month by more than 15 percent as compared to the same month in a previous year.⁴⁶⁷ The city must request the information within 90 days of discovering the reallocation or refund.⁴⁶⁸

What other information may a city obtain about businesses that collect sales taxes within the city?

Cities are somewhat limited by state law regarding the information that they can obtain from the comptroller about how much sales taxes, local or state, particular businesses collect within the city. Historically, it was believed that the proprietary nature of business sales information was too valuable to share with anyone other than state officials, lest businesses be tempted to move to

⁴⁶⁵ TEX. TAX CODE § 321.506.

⁴⁶⁶ TEX. TAX CODE § 321.508.

⁴⁶⁷ TEX. TAX CODE § 321.510(b).

⁴⁶⁸ TEX. TAX CODE § 321.510(f).

other states that didn't disclose that data. Whether or not this would happen in practice is debatable.

Specifically, a city may request information from the comptroller regarding sales taxes collected by businesses in the city that annually collect more than \$5,000 in state and local sales taxes.⁴⁶⁹ Cities that do not impose a property tax may request information from the comptroller regarding sales taxes collected by businesses in the city that annually collect more than \$500 in state and local sales taxes.⁴⁷⁰

Any city may request from the comptroller, however, aggregate sales tax collection data for businesses within a particular economic development zone or other defined region.⁴⁷¹ Such information is useful for revenue sharing arrangements and for economic forecasting, and must be kept confidential by the city and used only for those purposes.⁴⁷² A city council may meet in executive session to receive information about such confidential data.⁴⁷³

May a city rebate municipal sales taxes?

Yes. Cities may offer sales tax rebates and refunds for a period of up to ten years within neighborhood empowerment zones and North American Free Trade Agreement Impact Zones.⁴⁷⁴ Sales tax rebates also commonly occur pursuant to an economic development agreement adopted under Chapter 380 of the Local Government Code, and can be offered within a state enterprise zone.⁴⁷⁵

May a city offer to rebate city sales taxes to entice a business to move its call center into town?

Perhaps not. A rebate of city sales taxes to attract new business to a city is a legitimate economic development tool. But a city must be careful to avoid “purchasing office” schemes. Under such a scheme, a business with existing facilities in another city offers to move the business’ order-taking facility—often just a single office with a telephone—to a nearby city, provided the new city promises to rebate a portion of city sales taxes.

The scheme is based on the fact that the Texas Tax Code sources local sales taxes to the location where orders are received in cases where businesses have more than one physical location within the state.⁴⁷⁶ This sourcing rule is true even where the bulk of the business operations take place elsewhere.

⁴⁶⁹ TEX. TAX CODE § 321.3022(a-1).

⁴⁷⁰ TEX. TAX CODE § 321.3022(a-2).

⁴⁷¹ TEX. TAX CODE § 321.3022(b).

⁴⁷² TEX. TAX CODE § 321.3022(f).

⁴⁷³ TEX. TAX CODE § 321.3022(i).

⁴⁷⁴ TEX. LOC. GOV'T CODE §§ 378.004(2) and 379.004.

⁴⁷⁵ TEX. GOV'T CODE § 2303.505.

⁴⁷⁶ TEX. TAX CODE § 321.002(a)(3).

Legislation was passed in 2003 (as well as clarifying legislation in 2011) that prohibits the sourcing of sales taxes at locations only to alter the sourcing of sales taxes by setting up a purchasing office.⁴⁷⁷

Which utility services are subject to state and local sales taxes?

Residential and commercial use of water is not subject to the application of state or local sales taxes.⁴⁷⁸

Domestic sanitary sewer service is not subject to state or local sales taxes, nor is industrial discharge, provided it is regulated by the Texas Commission on Environmental Quality (TCEQ).⁴⁷⁹

Garbage collection service is subject to the state and local sales tax as a taxable real property service.⁴⁸⁰ Industrial solid waste is not taxable, however, nor are garbage collection services used by some contractors.

Gas and electricity that are sold for commercial use are subject to both state and local sales taxes.⁴⁸¹ Commercial use is defined as use by a person engaged in selling a commodity or service, but does not include manufacturing, mining, or agricultural activities. In other words, lighting, heating, and cooling services to most retail businesses are subject to sales tax unless they fit into the manufacturing exception.

Residential gas and electricity service is exempt from state sales taxes.⁴⁸² Residential gas and electricity are also exempt from city sales taxes, unless the city adopted a sales tax prior to October 1, 1979, and has acted by ordinance to tax gas and electricity.⁴⁸³ Cities that adopted a sales tax after October 1, 1979, may not tax residential gas and electric.

Cable television services are subject to both state and local sales taxes.⁴⁸⁴ This includes satellite T.V.⁴⁸⁵

Telecommunications services are generally subject to state sales taxes.⁴⁸⁶ Specifically exempt from sales taxes, however, are certain long-distance telephone services, commercial radio and television (other than cable), and a portion of monthly Internet access service charges.⁴⁸⁷

⁴⁷⁷ TEX. TAX CODE § 321.002(a)(3).

⁴⁷⁸ TEX. TAX CODE § 151.315.

⁴⁷⁹ TEX. TAX CODE § 151.0048(a)(3).

⁴⁸⁰ TEX. TAX CODE §§ 151.0048(a)(3) and 151.0048(b).

⁴⁸¹ TEX. TAX CODE § 151.317.

⁴⁸² TEX. TAX CODE § 151.317(a)(1).

⁴⁸³ TEX. TAX CODE § 321.105.

⁴⁸⁴ TEX. TAX CODE § 151.0101(a)(2).

⁴⁸⁵ 34 TEX. ADMIN. CODE § 3.133.

⁴⁸⁶ TEX. TAX CODE § 151.0101(a)(6).

⁴⁸⁷ TEX. TAX CODE §§ 151.323 and 151.325.

Telecommunications services are exempt from city sales taxes unless the city council repeals the exemption by an ordinance recorded in the minutes and filed with the comptroller.⁴⁸⁸ A city that repeals the exemption may tax only those telecommunications services taxable by the state, with the exception of otherwise taxable interstate long-distance services. Repeal of the city telecommunications exemption could be a significant source of new revenue for cities, but relatively few cities have taken advantage of it. See Chapter: *Sales Tax on Telecommunications Services*.

SALES TAX FOR PROPERTY TAX RELIEF

What is the sales tax for property tax relief?

The sales tax for property tax relief is an optional, dedicated city sales tax, the revenues of which offset an equivalent amount of city property tax revenue.

How does the sales tax for property tax relief increase city revenue?

It doesn't. The sales tax for property tax relief merely shifts existing revenue from property taxes to sales taxes.⁴⁸⁹

What good is the sales tax for property tax relief if it doesn't increase revenue?

Some cities find sales taxes preferable to property taxes for budgeting or political reasons.

How much sales tax for property tax relief may be levied by the city?

The rate of a sales tax for property tax relief may be any rate that is an increment of one-eighth of one percent that the city determines is appropriate.⁴⁹⁰ The combined rate of all local sales taxes within the city, however, cannot exceed two percent.⁴⁹¹

How is the sales tax for property tax relief enacted?

Like all optional, or dedicated, city sales taxes, the sales tax for property tax relief is adopted by an election of the citizens. An election may be called by the city council on its own motion, or

⁴⁸⁸ TEX. TAX CODE § 321.210.

⁴⁸⁹ TEX. TAX CODE § 321.507.

⁴⁹⁰ TEX. TAX CODE § 321.103(b).

⁴⁹¹ TEX. TAX CODE § 321.101(f).

must be called by the council upon receipt of a petition signed by at least five percent of the registered voters in the city.⁴⁹²

How does the sales tax for property tax relief operate to lower property taxes?

Revenues from the sales tax for property tax relief are subtracted from the city's no-new-revenue and voter-approval property tax rate calculations.⁴⁹³ This has the effect of decreasing property tax revenue by an equivalent amount.

If sales tax proceeds exceed the estimate used in calculating the no-new-revenue and voter-approval rate discounts, the excess revenues are deposited in a special account and may only be used for debt service.⁴⁹⁴

What is the sales tax for property tax relief also known as?

The Texas Tax Code does not use the term sales tax for property tax relief. Instead, the code refers to the "additional municipal sales and use tax." At the end of the sales tax chapter, however, it is explained that the additional sales tax may only be spent to reduce property taxes – hence the common term "sales tax for property tax relief."⁴⁹⁵

SALES TAX FOR STREET MAINTENANCE

What is the sales tax for street maintenance?

The sales tax for street maintenance is an optional, dedicated city sales tax, the revenues of which may be spent to repair and maintain existing city streets and sidewalks.

How much sales tax for street maintenance may be levied by the city?

The rate of a street maintenance sales tax may be any rate that is an increment of one-eighth of one percent that the city determines is appropriate.⁴⁹⁶ The combined rate of all local sales taxes within the city as a result of the adoption of the tax, however, cannot exceed two percent.⁴⁹⁷

⁴⁹² TEX. TAX CODE § 321.401(a) and (d).

⁴⁹³ TEX. TAX CODE § 26.041.

⁴⁹⁴ TEX. TAX CODE § 321.507(a).

⁴⁹⁵ TEX. TAX CODE § 321.507.

⁴⁹⁶ TEX. TAX CODE § 327.004.

⁴⁹⁷ TEX. TAX CODE § 327.003(b).

How is the sales tax for street maintenance adopted?

Like all optional, or dedicated, city sales taxes, the sales tax for property tax relief is adopted by an election of the citizens. An election is called by an ordinance adopted by the city council.⁴⁹⁸ The election may not be triggered by petition.

After an election to adopt a street maintenance sales tax, how long is the tax active?

Unlike nearly all other city sales taxes, the sales tax for street maintenance “sunsets,” or expires, after four years, unless another election is held.⁴⁹⁹ Legislation passed in 2013 and 2015 to allow two cities to hold reauthorization elections every eight and ten years, respectively, instead of every four years.⁵⁰⁰

May the sales tax for street maintenance be used to build new streets?

No. The sales tax for street maintenance may be used only to maintain and repair city streets and sidewalks existing on the date of the election to adopt the tax.⁵⁰¹ Many city attorneys believe that the sales tax for street maintenance could also be used to maintain and repair city streets and sidewalks existing on the date of a subsequent reauthorization of the tax.

SALES TAX ON RESIDENTIAL GAS AND ELECTRICITY

What is the sales tax on residential gas and electricity?

The sales tax on residential gas and electricity is not really a separate city sales tax. Rather, it represents the optional repeal of an exemption to the city’s other sales taxes.

Residential gas and electricity service is usually exempt from state sales taxes.⁵⁰² Residential gas and electricity are also exempt from city sales taxes, *unless the city adopted a sales tax prior to October 1, 1979, and has acted by ordinance, recorded in the minutes, to tax gas and electricity.*⁵⁰³

⁴⁹⁸ TEX. TAX CODE § 327.006.

⁴⁹⁹ TEX. TAX CODE § 327.007(a).

⁵⁰⁰ TEX. TAX CODE §§ 327.007(a)(2-a) and (3).

⁵⁰¹ TEX. TAX CODE § 327.008.

⁵⁰² TEX. TAX CODE § 151.317(a).

⁵⁰³ TEX. TAX CODE § 321.105.

Repealing the city exemption on residential gas and electricity can be a significant source of new city revenue; for obvious reasons, it can also be politically challenging.

Which cities can repeal the exemption on residential gas and electricity?

As stated above, only cities that had a sales tax in place prior to October 1, 1979, are eligible to repeal the exemption.

Any city that was created since October 1, 1979, or was in existence on that date but had no sales tax, cannot repeal the exemption.

What steps must a city take to tax residential gas and electricity?

Following are the steps necessary to tax residential gas and electricity:

- (1) Adopt an ordinance by *majority vote of the membership* of the city council.⁵⁰⁴ By using the phrase “of the membership,” it is clear that the vote needed is a majority of the entire council, not just a majority of those present and voting, as is usually required to pass an agenda action item.
- (2) Record the vote in the minutes of the city.
- (3) The city secretary must send a copy of the ordinance to the comptroller by registered or certified mail.⁵⁰⁵

How many Texas cities have repealed the tax exemption on residential gas and electricity?

According to 2019 comptroller data, 783 cities have repealed the exemption on residential gas and electricity. That leaves 135 cities that are eligible to repeal the exemption but have not done so.⁵⁰⁶

SALES TAX ON TELECOMMUNICATIONS SERVICES

What is the sales tax on telecommunications services?

The sales tax on telecommunications services is not really a separate city sales tax. Rather, it represents the optional repeal of an exemption to the city’s other sales taxes.

⁵⁰⁴ TEX. TAX CODE § 321.105(c).

⁵⁰⁵ TEX. TAX CODE § 321.105(d).

⁵⁰⁶ <https://comptroller.texas.gov/taxes/sales/utility>

Telecommunications services are generally subject to state sales taxes.⁵⁰⁷ Specifically exempt from sales taxes, however, are certain long-distance telephone services, commercial radio and television (other than cable), and a portion of monthly Internet access service charges.⁵⁰⁸

Telecommunications services are exempt from city sales taxes *unless the city council repeals the exemption by an ordinance recorded in the minutes and filed with the comptroller.*⁵⁰⁹ A city that repeals the exemption may tax only those telecommunications services taxable by the state, with the exception of otherwise taxable interstate long-distance services.

Repeal of the city telecommunications exemption could be a significant source of new revenue for cities, but many cities do not take advantage of it.

What are telecommunications services?

According to the Texas Tax Code, telecommunications services are:

...the electronic or electrical transmission, conveyance, routing, or reception of sounds, signals, data, or information utilizing wires, cable, radio waves, microwaves, satellites, fiber optics, or any other method not in existence or that may be devised, including but not limited to long-distance telephone service. The term does not include: (1) the storage of data or information for subsequent retrieval or the processing, or reception and processing, of data or information intended to change its form or content; (2) the sale or use of a telephone prepaid calling card; (3) Internet access service; or (4) a pay telephone coin sent-paid telephone call.⁵¹⁰

Which cities can repeal the exemption on telecommunications services?

All cities that have adopted sales taxes are eligible to repeal the exemption on telecommunications services.⁵¹¹

What steps must a city take to repeal the exemption on telecommunications services?

- (1) Adopt an ordinance by majority vote of the city council that repeals the exemption.⁵¹²

⁵⁰⁷ TEX. TAX CODE § 151.0101(a)(6).

⁵⁰⁸ TEX. TAX CODE §§ 151.323 and 151.325.

⁵⁰⁹ TEX. TAX CODE §§ 321.210.

⁵¹⁰ TEX. TAX CODE § 151.0103.

⁵¹¹ This is contrasted with repeal of the exemption for residential gas and electricity, which can only be accomplished by cities that had a sales tax prior to October 1, 1979.

⁵¹² TEX. TAX CODE § 321.210(b).

- (2) Record the votes in the minutes of the city council.⁵¹³
- (3) The city secretary must send a copy of the ordinance to the comptroller by certified or registered mail.⁵¹⁴

How many Texas cities impose sales taxes on telecommunication services?

According to 2019 comptroller data, 531 cities have repealed the tax exemption and impose sales taxes on telecommunication services.⁵¹⁵

SPECIAL IMPROVEMENT DISTRICT FUND TAX

What is a special improvement district fund tax?

A city council may levy an annual tax to support the administrative and planning elements of a public improvement district (PID).⁵¹⁶ No procedures are specified in the chapter for levying this tax.

See Chapter: *Assessments*.

STREET ASSESSMENTS

What are street assessments?

Cities may require adjoining landowners to share in the cost of street improvements within the city. The landowners' share is known as a street assessment and is governed by the Texas Transportation Code. Separate statutes apply to home rule and general law cities.

A city should be careful to contrast street assessments, which can be unilaterally imposed on landowners, with assessments within public improvement districts (PIDs), which can be used for street improvement but require the petition of the landowners to initiate. For a discussion of assessments within PIDs, see Chapter: *Assessments*.

⁵¹³ TEX. TAX CODE § 321.210(d).

⁵¹⁴ TEX. TAX CODE § 321.210(d).

⁵¹⁵ <https://comptroller.texas.gov/taxes/publications/96-339.php>

⁵¹⁶ TEX. LOC. GOV'T CODE § 372.021.

How do home rule cities levy street assessments?

Home rule cities may assess a landowner for the cost of improving a city street if the city's charter provides for apportioning the cost between the city and the landowner.⁵¹⁷

Home rule cities that are authorized by their charters to levy street improvement assessments may not levy an assessment in an amount that exceeds the amount by which the improvement specially benefits the owner's abutting land by enhancing the land's value.⁵¹⁸ This peculiar statute thus limits the amount of street assessments in home rule cities to the financial benefit on the adjoining land, which is no doubt lower than the cost of the street improvement, in many cases.

Home rule cities may also levy assessments for opening (building), extending, or widening new city streets following eminent domain of the right-of-way.⁵¹⁹ The city's share of street construction shall be no more than one-third of the total cost, with the landowner paying two-thirds.⁵²⁰

How do general law (Type A) cities levy street assessments?

Type A general law cities actually have a more favorable street improvement assessment statute than do home rule cities. Type A cities may levy a street assessment against landowners abutting a street improvement if two-thirds of the councilmembers present vote for the assessment.⁵²¹

A street assessment in a Type A general law city must apportion the costs at two-thirds to the landowner, one-third to the city.⁵²² The landowners must be permitted to pay their two-thirds cost assessment in not fewer than five equal, annual payments.⁵²³ The assessment constitutes a lien against the property.⁵²⁴

Is there any other authority for a city to levy street assessments?

Yes. Interestingly, Chapter 313 of the Transportation Code authorizes any city with a population of over 1,000 to impose assessments to pay for improvements to city streets. This authority is separate from cities' authority to impose assessments pursuant to Chapter 311, Subchapter E, of the Transportation Code, which is discussed above.

Under this alternate street assessment process, cities—by ordinance—may assess the cost of an improvement against property that abuts the city street or portion of the street that is to be

⁵¹⁷ TEX. TRANSP. CODE § 311.091(a).

⁵¹⁸ TEX. TRANSP. CODE § 311.091(a).

⁵¹⁹ TEX. TRANSP. CODE § 311.092.

⁵²⁰ TEX. TRANSP. CODE § 311.092(b).

⁵²¹ TEX. TRANSP. CODE § 311.095(a).

⁵²² TEX. TRANSP. CODE § 311.095(b).

⁵²³ TEX. TRANSP. CODE § 311.095(c).

⁵²⁴ TEX. TRANSP. CODE § 311.095(f).

improved.⁵²⁵ A city council may not assess more than nine-tenths of the estimated cost of a street improvement against an abutting property, but may assess the entire cost of constructing or repairing a curb, gutter, or sidewalk against an abutting property.⁵²⁶ The ordinance may prescribe the terms of payment and default of the assessment, including setting the interest rate at a rate not to exceed eight percent per year.⁵²⁷

An assessment under Chapter 313 of the Transportation Code can only be imposed after the city council has prepared an estimate of the cost of the improvement, provided proper notice of a hearing on the proposed assessment, and held the assessment hearing.⁵²⁸ Written notice must be mailed to all property owners abutting the part of the street to be improved and must be published in the local newspaper at least three times, with the first published notice running not later than the 21st day before the hearing date.⁵²⁹ In order to be considered sufficient, the notice must: (1) describe the nature of the improvement for which the assessment will be imposed; (2) describe the portion of the street to be improved; (3) state the estimated amount per front foot proposed to be assessed; (4) state the estimated total cost of the improvement; (5) state the amount proposed to be assessed in the area near a railway; and (6) state the time and place of the hearing.⁵³⁰

An assessment imposed under Chapter 313 of the Transportation Code constitutes a lien on the property that is superior to any other lien or claim except a lien or claim for property taxes.⁵³¹

TIME WARRANTS

What is a time warrant?

A time warrant is defined by state statute as “any warrant issued by a municipality that is not payable from current funds.”⁵³² Time warrants are non-negotiable instruments that are issued to obtain property or labor on credit, and are delivered to the contractor rather than sold for cash.⁵³³ Practically speaking, time warrants are seldom used, because cities generally find it advantageous to utilize other financing alternatives like certificates of obligation.

Must voters approve time warrants?

⁵²⁵ TEX. TRANSP. CODE § 313.042(a).

⁵²⁶ TEX. TRANSP. CODE §§ 313.042(b) and (c).

⁵²⁷ TEX. TRANSP. CODE § 313.042(d).

⁵²⁸ TEX. TRANSP. CODE §§ 313.024, 313.047, and 313.048.

⁵²⁹ TEX. TRANSP. CODE § 313.047.

⁵³⁰ TEX. TRANSP. CODE § 313.047(f).

⁵³¹ TEX. TRANSP. CODE § 313.042(e).

⁵³² TEX. LOC. GOV'T CODE § 252.001(8).

⁵³³ See *City of Del Rio v. Lowe*, 111 S.W.2d 1208, 1214 (Tex.Civ.App.—San Antonio, 1937, rev'd on other grounds, 132 Tex. 111, 122 S.W.2d 191 (1938)); see also *Lewis v. Nacogdoches County*, 461 S.W.2d 514, 518. (Tex.Civ.App.—Tyler 1970, no writ).

Although there is no up-front election requirement for the issuance of a time warrant (as there is for general obligation bonds), a city may be petitioned by city taxpayers to conduct an election. If at least 10 percent of the qualified voters of the city whose names also appear as property taxpayers from the most recently approved tax roll sign a petition requesting a referendum on the question of whether time warrants should be issued, the city may not authorize the expenditure unless first approved by a majority at an election held by the city.⁵³⁴ However, a petition for a referendum election may not be submitted if the total amount of time warrants issued by a city in a calendar year falls below a specified amount as follows:

- (1) \$7,500 if the city's population is 5,000 or less;
- (2) \$10,000 if the city's population is 5,001 to 24,999;
- (3) \$25,000 if the city's population is 25,001 to 49,999; or
- (4) \$100,000 if the city's population is more than 50,000.⁵³⁵

Must notice be given of the issuance of time warrants?

Yes, if a city intends to issue time warrants for the payment of a contract procured under Chapter 252 of the Local Government Code. In that case, the city must include in the notice a statement of: (1) the city council's intention to issue time warrants; (2) the maximum amount of the proposed time warrant indebtedness; (3) the rate of interest the time warrants will bear; and (4) the maximum maturity date of the time warrants.⁵³⁶

Does a time warrant need to receive attorney general approval?

No. Time warrants are specifically exempted from the general requirement that a public security be approved by the Texas Attorney General.⁵³⁷

TRAFFIC FINE REVENUE

Is there a limit on how much city revenue can come from traffic fines?

⁵³⁴ TEX. LOC. GOV'T CODE § 252.045(a).

⁵³⁵ TEX. LOC. GOV'T CODE § 252.023.

⁵³⁶ TEX. LOC. GOV'T CODE § 252.041(d).

⁵³⁷ TEX. GOV'T CODE § 1202.007(a)(4).

Yes, for cities under 5,000 population, the annual revenue from traffic fines (including deferred disposition special expenses) may not exceed 30 percent of a city's total annual revenue from all sources, other than federal funds and bond proceeds.⁵³⁸

The restriction only applies to cities under 5,000 population; larger cities are not affected.

Who enforces the 30-percent restriction?

The Texas Comptroller enforces the 30-percent traffic fine restriction, and may conduct audits.⁵³⁹ Further, a city that legally collects between 20 and 30 percent of its annual revenue from traffic fines must send the comptroller its annual financial report and a report that shows the total amount collected during the year from traffic fines and special expenses.⁵⁴⁰ Failure to properly send the reports to the comptroller results in the city being responsible for the costs of any audit.⁵⁴¹

What is the consequence for a city that receives more than 30 percent of its revenue from traffic fines?

Any fine money that exceeds the 30-percent limit is forfeited to the comptroller, except for \$1 of each fine.⁵⁴²

Don't city-option court costs simply have the effect of replacing an equivalent amount of fine revenue, as judges are likely to consider the total payment when assessing a fine?

Yes and no. It is true that judges tend to adjust assessed fines downward to account for court costs. What's also true, however, is that the vast majority of court costs—roughly \$82 for a basic speeding ticket—go straight to the state to fund state activities. Furthermore, state fees and costs tacked onto municipal court fines have complete precedence over the fine. For instance, if a defendant has \$83 to his name, the first \$82 goes to the state and the city gets to keep the \$1, regardless of the actual fine. Local-option court costs have the effect of correcting this discrepancy to some degree, as all court costs (local and state) are treated equally.

USER FEES

What are user fees?

⁵³⁸ TEX. TRANSP. CODE § 542.402(b).

⁵³⁹ TEX. TRANSP. CODE § 542.402(c).

⁵⁴⁰ TEX. TRANSP. CODE § 542.402(d).

⁵⁴¹ TEX. TRANSP. CODE § 542.402(e).

⁵⁴² TEX. TRANSP. CODE § 542.402(b).

For purposes of this handbook, user fees are any charges that a city levies for the right to use city services or facilities that aren't otherwise covered in this manual. For example, if a city operates a municipal swimming pool and charges a \$2 entry fee, that constitutes a user fee, and is perfectly legal. Building permitting and inspection fees may also be viewed as a user fee, in that the builder pays for the cost of the particular city service (in this case, permitting and inspections).

When are user fees legal, and when are they illegal?

There are only a handful of cases and opinions that deal with the legality/illegality of user fees. The principal legal issue is this: when does a user fee, which is routine and legal, cross over into the realm of a "tax," which is illegal unless a city can point to a specific authority that authorizes a tax?

Two general guidelines emerge from reading the opinions and cases:

- (1) **A user fee should bear some relation to the actual cost of providing a service.** For example, if a \$2 swimming pool fee raises \$50,000 a year in revenue, and the cost of personnel, maintenance, and other items relating to operating a city pool is somewhere in the \$50,000 range, such a fee is clearly legal. On the other hand, if the fee raised two or three times the revenue necessary to operate the pool, the excess revenue runs the risk of being labeled a "tax."

General law cities have no authority to levy a "swimming pool tax." As a result, such a fee would be in danger of being struck down by a court. General law cities possess only those taxing powers that the legislature or the constitution expressly grant them.⁵⁴³ For home rule cities, the issue is more complicated, as it is unclear what taxing authority a home rule city can derive solely from its charter. Home rule city officials should discuss the issue with their city attorney.

- (2) **A user fee shouldn't be attached to a bill for unrelated services.** For example, the Texas Attorney General has concluded that a general law city may not attach a monthly fee on utility bills to finance the police department.⁵⁴⁴ Nor may a city attach a mandatory fee in water bills to pay for volunteer fire fighting services.⁵⁴⁵

UTILITY FEES

How much may cities charge as utility fees?

⁵⁴³ *Vance v. Town of Pleasanton*, 261 S.W. 457, 458 (Tex. Civ. App.—San Antonio 1924).

⁵⁴⁴ Op. Tex. Att'y Gen. No. JM-338 (1985).

⁵⁴⁵ Op. Tex. Att'y Gen. No. GA-84 (2003).

Similar to user fees generally (see above), utility fees must bear some relation to the actual cost of providing the utility service. Utility billing is different from other fees in one important way, however: it has long been recognized that cities may make also a reasonable profit from operation of their utility system.⁵⁴⁶ A city can transfer the reasonable profit to the city's general fund, provided the amount complies with the provisions of any debt instrument that is paid by the utility proceeds.

A court may grant relief, however, to utility customers who can prove that a city's profit or return is unreasonable and excessive.⁵⁴⁷

May a city charge a late fee for delinquent utility bills?

Yes. A late charge on utility services bills is neither illegal interest nor penalty, but a cost of doing business properly assessed against a delinquent customer.⁵⁴⁸ A late fee should be authorized by the utility ordinance.

VENUE TAXES

What are venue taxes?

Venue taxes are a collection of different taxes that a city is authorized to levy within the city to fund a "venue project." Some of the taxes might already be imposed by the city, like sales taxes and hotel occupancy taxes, and the "venue tax" would be an increased rate on the tax that would be dedicated to the venue project. Other venue taxes are new types of taxes that are created to fund the project.

What are "venue projects" that may be funded by venue taxes?

When venue taxes were authorized in 1997, they were established as a means of providing facilities for professional athletic teams and other recreational activities deemed to be of benefit to a community. Since 1997, the definition of "venue project" has broadened to encompass additional purposes.

⁵⁴⁶ *San Antonio Ind. S.D. v. City of San Antonio*, 550 S.W.2d 262, 264 (Tex. 1976).

⁵⁴⁷ *San Antonio, supra*, at 265, citing *State v. Southwestern Bell Tel. Co.*, 526 S.W.2d 526 (Tex. 1975).

⁵⁴⁸ Op. Tex. Att'y Gen. No. H-1289 (1978).

Venue projects are now defined as arenas, coliseums, stadiums, and other facilities that are used for sports and community events and for which a fee for admission is charged.⁵⁴⁹ The term also includes convention and civic centers, civic center hotels, auditoriums, museums, plazas, and parks in the vicinity of a convention center facility.⁵⁵⁰

Also, a venue project includes any authorized project under the Type A and Type B economic development sales tax laws as they existed on September 1, 1997, a municipal parks and recreation system or improvements to such a system, and watershed protection and preservation projects.⁵⁵¹

What are the different venue taxes that can be levied to fund venue projects?

The following taxes are all available to fund venue projects. These taxes may be levied in addition to similar taxes the city already levies for other purposes, including for general revenue.

- (1) **Sales Tax.** A city may levy an optional sales tax for funding the venue project at any rate that is an increment of one-eighth of one percent that the city determines is appropriate.⁵⁵² However, the total combined tax rate within the city may not exceed two percent.⁵⁵³ If the total tax rate within a city is maxed-out at the two percent local sales tax cap, state statute allows the adoption of the venue sales tax to cause the local sales tax rate of one of four other taxing authorities in the area to be automatically reduced or require the city to withdraw from the other taxing authority in order to make room for the venue sales tax.⁵⁵⁴ The four taxing entities that may have their sales tax rate reduced to allow for a venue sales tax are: (1) a rapid transit authority; (2) a regional transportation authority; (3) a crime control and prevention district; and (4) an economic development corporation.⁵⁵⁵
- (2) **Short-Term Motor Vehicle Rental Tax.** A city may levy a tax on the rental of motor vehicles for less than 30 days within the city at a rate not to exceed five percent.⁵⁵⁶ Revenue from the motor vehicle rental tax may not be used to finance a parks and recreation system that would otherwise qualify as a venue project.⁵⁵⁷ A city may impose a motor vehicle rental tax only if the city issues bonds or other obligations before the first anniversary of the date the tax is imposed.⁵⁵⁸

⁵⁴⁹ TEX. LOC. GOV'T CODE § 334.001(4)(A).

⁵⁵⁰ TEX. LOC. GOV'T CODE § 334.001(4)(B).

⁵⁵¹ TEX. LOC. GOV'T CODE § 334.001(4)(D), (E), and (F).

⁵⁵² TEX. LOC. GOV'T CODE § 334.083.

⁵⁵³ TEX. LOC. GOV'T CODE § 334.082(a) and TEX. TAX CODE § 321.101(f).

⁵⁵⁴ TEX. LOC. GOV'T CODE § 334.085.

⁵⁵⁵ TEX. LOC. GOV'T CODE § 334.085.

⁵⁵⁶ TEX. LOC. GOV'T CODE §§ 334.101 and 334.103.

⁵⁵⁷ TEX. LOC. GOV'T CODE § 334.1015.

⁵⁵⁸ TEX. LOC. GOV'T CODE § 334.112(b).

- (3) **Parking Tax.** A city may generally levy a tax on each motor vehicle that parks at a venue project facility at a flat rate not to exceed \$3.⁵⁵⁹ A city may impose a parking tax only if the city issues bonds or other obligations to finance the venue project.⁵⁶⁰
- (4) **Hotel Occupancy Tax.** A city may levy a hotel occupancy tax at a rate not to exceed two percent on all hotels in the city to fund certain venue projects, except that a city may not propose a hotel occupancy tax rate that would cause the combined hotel occupancy tax rate imposed from all sources at any location in the city to exceed 17 percent of the price of a room.⁵⁶¹ Revenue generated by the venue hotel occupancy tax may not be spent on park and recreation systems, watershed protection and preservation projects, and certain Type A or Type B EDC projects.⁵⁶² A city may impose a hotel occupancy tax only if the city issues bonds or other obligations before the first anniversary of the date the tax is imposed.⁵⁶³
- (5) **Facility Use Tax.** A city may levy a tax on each member of a professional sports team who uses a venue project facility for a game. The rate may be up to \$5,000 per player per game.⁵⁶⁴ A facility use tax may only be imposed if the city has issued bonds to plan, acquire, establish, develop, construct, or renovate the approved venue project.⁵⁶⁵
- (6) **Livestock Facility Use Tax.** A city may levy a tax not to exceed \$20 on each stall or pen at a livestock show or rodeo at a venue project facility.⁵⁶⁶
- (7) **Admissions Tax.** A city may levy a tax not to exceed ten percent of the price of an admission ticket to a venue project facility event.⁵⁶⁷ An admissions tax may only be imposed if the city has issued bonds to plan, acquire, establish, develop, construct, or renovate the approved venue project.⁵⁶⁸

How are venue taxes levied?

All venue taxes, as well as the underlying venue project, must be approved at an election of the city's voters. The voters must be allowed to vote on each venue project, as well as on each separate venue tax that is proposed to finance that project.⁵⁶⁹

⁵⁵⁹ TEX. LOC. GOV'T CODE § 334.202.

⁵⁶⁰ TEX. LOC. GOV'T CODE § 334.205(b).

⁵⁶¹ TEX. LOC. GOV'T CODE § 334.254.

⁵⁶² TEX. LOC. GOV'T CODE §§ 334.2515 and 334.2517.

⁵⁶³ TEX. LOC. GOV'T CODE § 334.257(b).

⁵⁶⁴ TEX. LOC. GOV'T CODE § 334.303.

⁵⁶⁵ TEX. LOC. GOV'T CODE § 334.302(b).

⁵⁶⁶ TEX. LOC. GOV'T CODE § 334.404.

⁵⁶⁷ TEX. LOC. GOV'T CODE § 334.152.

⁵⁶⁸ TEX. LOC. GOV'T CODE § 334.151(b).

⁵⁶⁹ TEX. LOC. GOV'T CODE § 334.024.

Prior to the election, the Texas Comptroller must determine that the venue project and accompanying taxes won't negatively impact state revenue.⁵⁷⁰ This process is triggered once the city council adopts a resolution authorizing the project and submits the resolution to the comptroller.⁵⁷¹ If the comptroller determines that the venue project will have a negative fiscal impact on state revenue, the comptroller must indicate in writing how the city could change the resolution so that there would not be a negative impact.⁵⁷² The city has 10 days to appeal the comptroller's decision.⁵⁷³

Does specific ballot language need to be used in a venue tax election?

Yes. Chapter 334 of the Local Government Code contains specific language that must be used for each type of venue tax proposition. In all cases, the required language includes a description of the project and language specifying the tax rate. The attorney general has concluded that the language of an election order for a venue project creates a "contract with the voters" in terms of the permissible projects for which venue tax revenue may be spent.⁵⁷⁴

How must the city handle venue tax revenue?

Once the voters have authorized a tax to support a venue project, the city must establish by resolution a fund known as the venue project fund.⁵⁷⁵ The city must deposit certain revenue into the venue project fund, including any venue tax proceeds and all revenue from the sale of bonds or other debt obligations.⁵⁷⁶ A city has the discretion to deposit various other sources of revenue associated with a venue project into the fund.⁵⁷⁷ A city is required to establish separate accounts within the fund for the various revenue sources.⁵⁷⁸

Money in the venue project fund may be used by the city to: (1) pay the costs of operating or maintaining a venue project; (2) reimburse or pay the costs of planning, acquiring, establishing, developing, constructing, or renovating one or more approved venue projects; or (3) pay the principal, interest, or other costs relating to bonds or other debt obligations issued by the city to support a venue project.⁵⁷⁹

⁵⁷⁰ TEX. LOC. GOV'T CODE § 334.022.

⁵⁷¹ TEX. LOC. GOV'T CODE § 334.021.

⁵⁷² TEX. LOC. GOV'T CODE § 334.022.

⁵⁷³ TEX. LOC. GOV'T CODE § 334.023.

⁵⁷⁴ Tex. Att'y. Gen. Op. No. GA-0156 (2004).

⁵⁷⁵ TEX. LOC. GOV'T CODE § 334.042(a).

⁵⁷⁶ TEX. LOC. GOV'T CODE § 334.042(b).

⁵⁷⁷ TEX. LOC. GOV'T CODE § 334.042(c).

⁵⁷⁸ TEX. LOC. GOV'T CODE § 334.042(a).

⁵⁷⁹ TEX. LOC. GOV'T CODE § 334.042(d).