

Legal Q&A

By Bill Longley, TML Legal Counsel

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

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

What is the sales tax for general revenue?

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

The city sales tax for general revenue, if adopted, is set at one percent—no higher or lower. TEX. TAX CODE § 321.103(a). A city may adopt additional sales taxes beyond the one-percent tax, but all such additional sales taxes are for dedicated purposes, and not for general revenue. The vast majority of Texas cities have adopted a one-percent sales tax for general revenue.

What are sales taxes for dedicated purposes?

All city sales taxes, other than the sales tax for general revenue, would be considered sales taxes for dedicated purposes. As the name implies, each of these taxes may only be spent on certain, or dedicated, items or projects. Among the different types of dedicated sales taxes are the Type A or Type B economic development corporation sales tax, the street maintenance sales tax, sales tax for property tax relief, sales tax for a crime control and prevention district, sales tax for a municipal development district, and a venue project sales tax.

Cities may have a mix of different dedicated taxes, in addition to the general revenue sales tax, so long as the total tax rate in the city does not exceed 8.25 percent. The maximum rate for each dedicated sales tax varies from one-fourth to one-half of one percent, depending on the tax.

How does a city adopt the sales tax for general revenue or a dedicated sales tax?

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

TEX. TAX CODE §§ 321.401 and 321.101(c). Likewise, each authorizing statute for a dedicated sales tax requires each dedicated sales tax to be adopted by city voters at an election.

An election to adopt either a general or dedicated sales tax generally cannot be held earlier than one year after the date of any previous sales tax election in the city. TEX. TAX CODE § 321.406; *see also* Tex. Att’y. Gen. LO-98-074 (1998).

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

Yes. A city may hold an election to repeal or lower one dedicated sales tax, and raise or adopt a different sales tax, all with one combined ballot proposition. TEX. TAX CODE § 321.409. The fact that this can be accomplished by one combined ballot proposition protects the city’s interest by eliminating the risk that one tax will be voted out by the citizens without the other tax being voted in. A combined ballot proposition must be worded to contain substantially the same language required by law for each of the two taxes individually. TEX. TAX CODE § 321.409(b).

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

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

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

Although a city is permitted to have a combined ballot proposition to switch from an EDC sales tax to an 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, 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) allow voters inside the city limits to impose the MDD sales tax in an area in which the actual residents living in that area did not have the opportunity to vote.

In at least one instance, the comptroller’s office refused to honor the results of a combined ballot proposition to replace the EDC sales tax with the MDD sales tax because the city permitted voters in the ETJ to vote on the proposition that would (in part) abolish the EDC sales tax, even though that tax was never imposed in the ETJ. Because the comptroller has taken this position in

the past, a city should consider using two separate ballot propositions if the boundaries of the MDD will differ at all from the boundaries of the EDC.

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

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

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

How are city sales taxes collected?

All city sales taxes are collected by the Texas Comptroller, along with the state sales tax. TEX. TAX CODE § 321.301. The comptroller then remits the city its portion of the taxes at least twice a year (though it is done more often in practice). TEX. TAX CODE § 321.502.

The comptroller keeps two percent of city sales taxes as payment for the state's services in collecting the tax. TEX. TAX CODE § 321.503. 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.

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

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. TEX. TAX CODE § 321.3022(a-1). 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. TEX. TAX CODE § 321.3022(a-2).

Any city may request from the comptroller aggregate sales tax collection data for businesses within a particular economic development zone or other defined region. TEX. TAX CODE § 321.3022(b). 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. TEX. TAX

CODE § 321.3022(f). A city council may meet in executive session to receive information about such confidential data. TEX. TAX CODE § 321.3022(i).

Additionally, 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: (1) \$200,000; (2) ten percent of the revenue received by the city during the previous calendar year; or (3) 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. TEX. TAX CODE § 321.510(b). The city must request the information within 90 days of discovering the reallocation or refund. TEX. TAX CODE § 321.510(f).