Legal Q&A
By Bill Longley, TML General Counsel

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

A 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. *See* 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 for a total maximum tax rate of 8.25 percent in any given location. *See id.* § 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.

Q What is the sales tax for general revenue?

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

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

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

The sales tax for general revenue is adopted by an election of the city voters. *See id.* § 321.101(a). A sales tax for general revenue election may be called by either of two methods: (1) the city council may 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. *See id.* § 321.401.

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.

Q What are sales taxes for dedicated purposes?

A All city sales taxes, other than the sales tax for general revenue, are considered sales taxes for dedicated purposes. As the name implies, each of these taxes may only be spent on certain, or

dedicated, items or projects. Cities may have a mix of different dedicated taxes, in addition to the general revenue sales tax, so long as the total tax rate in the city does not exceed 8.25 percent.

Prior to the passage of H.B. 157 in 2015, 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 removed 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. *See* TEX. TAX CODE § 321.406, *see also* Tex. Att'y. Gen. LO-98-074 (1998).

Q Our city is "maxed out" at the two-percent sales tax cap. May we hold an election to switch from one city sales tax to another?

A Yes. A city may hold an election to repeal or lower one city sales tax, and raise or adopt a different sales tax, all with one combined ballot proposition. *See* TEX. TAX CODE § 321.409. The fact that this may 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. *See id.* § 321.409(b).

Note that prior to 2017, the law only authorized a city to use a combined ballot proposition when switching from one dedicated city sales tax to another dedicated city sales tax. In 2017, H.B. 3046 passed, which expanded the applicability of the combined ballot proposition statute to *all* city sales taxes, including the general revenue sales tax. *See id.* § 321.409(a).

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

A 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), or receive a petition to repeal or reduce the tax from the voters, if applicable, in order to free up a portion of the local two-percent cap for another local taxing entity to claim.

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).

Q Are remote sellers required to collect local sales and use taxes in Texas?

A Yes. In June 2018, the United States Supreme Court in *Wayfair v. South Dakota* held that a South Dakota state law requiring certain remote sellers to collect sales taxes on goods shipped to customers living in South Dakota was constitutional. In doing so, the Court overturned decades of legal precedent providing that states could only require sellers to collect state and local sales taxes when they had a physical presence in a state.

In response to *Wayfair*, Texas statute and the state comptroller's administrative rules were amended to generally require remote sellers to collect sales taxes beginning on October 1, 2019. The comptroller's rules define a "remote seller" to mean a seller engaged in business in Texas whose only activity in the state is "engaging in regular or systematic solicitation of sales of taxable items in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, by means of print, radio, or television media, or by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system for the purpose of effecting sales of taxable items" or "soliciting orders for taxable items through mail or through other media including the Internet or other media that may be developed in the future." 34 TEX. ADMIN. CODE § 3.334(a)(18). Put more simply, remote sellers are out-of-state sellers whose only activity in Texas is the remote solicitation of sales, such as sales made over the internet.

When an order is not received at a Texas place of business, as is the case for any remote sale, local use tax must generally be collected by the remote seller based on the location in Texas where the order is shipped or received. *See* TEX. TAX CODE § 321.205(c); 34 TEX. ADMIN. CODE § 3.334(c)(2)(B)(ii).

There are exceptions to the general requirement that remote sellers collect and remit state and local use tax. Remote sellers are exempt from having to collect the tax if they fall within the statutory "safe harbor" provision, which exempts remote sellers with total Texas revenue of less than $500,000 in the preceding 12 calendar months. *See* 34 TEX. ADMIN. CODE § 3.286(b)(2). Further, remote sellers have the ability to collect a single local use tax in lieu of use taxes based upon the destination where the order is received. *See* TEX. TAX CODE § 151.0595.

Q What is the single local use tax?

A H.B. 2153, passed and signed into law in 2019, created the single local use tax as an alternative tax that remote sellers may use instead of collecting and remitting the total use tax in effect at the destination address. The underlying policy rationale behind the single local use tax was to allow remote sellers to forego the burden of tracking the specific sales and use tax in each Texas jurisdiction where a purchaser is located, and instead elect to collect and remit one uniform use tax on all sales made in Texas.

The comptroller must apportion and distribute revenue received from the single local use tax to each eligible taxing unit, including cities, in proportion to the amount of total sales and use tax allocations made to the taxing unit each month. *See* TEX. GOV'T CODE § 403.107(e).

The single local use tax rate effective in a given year is a rate equal to the estimated average rate of local sales and use taxes imposed in this state during the preceding state fiscal year, as determined by the comptroller. *See* TEX. TAX CODE § 151.0595(d). The current local use tax rate in Texas is 1.75 percent. *See* 34 TEX. ADMIN. CODE § 3.334(i)(3)(D).

Q How are internet orders sourced for sellers with a place of business in Texas?

A In May 2020, the comptroller adopted new rules applicable to the sourcing of sales taxes for intrastate internet orders. The new rules provide that orders received via a shopping website or software application are received at a location that is not a place of business in the state. *See* 34 TEX. ADMIN. CODE § 3.334(b)(5). The ultimate impact of this change is that, under the provisions governing where a sale is consummated, certain internet purchases may no longer be sourced to the location where the order is received. Under the new rules, internet orders are sourced to either the location where the order is fulfilled or the location where the order is received by the purchaser, depending on the exact circumstances. *See* 34 TEX. ADMIN. CODE § 3.334(c)(1)(B). By comparison, nothing in the rule changes the sourcing of orders placed in person in Texas; in-person orders at a place of business in Texas are consummated at the place of business, regardless of where the order is fulfilled. *See* 34 TEX. ADMIN. CODE § 3.334(c)(1)(A).

Of particular significance to Texas cities, the May 2020 rules are not effective until October 1, 2021. The comptroller, according to the description published in the Texas Register, delayed the implementation of the rules in order to give "interested parties an opportunity to seek a legislative change." 45 Tex. Reg. 3499 (2020) (34 TEX. ADMIN. CODE § 3.334) (May 22, 2020). Any legislative changes will be reported in the TML Legislative Update, available here: https://www.tml.org/579/Legislative-Update.