Local Sales Tax Bill Gives Cities Increased Financial Flexibility

On June 20, Governor Abbott signed H.B. 157 (Larson/Eltife) into law. The bill authorizes a city to hold an election to *reallocate sales tax revenue*. By doing so, it allows a city to determine whether dedicated sales taxes should be increased or decreased, or whether a general revenue sales tax better serves its needs. (The bill does not allow an increase above the two percent local cap. It authorizes reallocation by election within a percentage that is below that cap.)

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

The state's sales tax rate is 6.25 percent. Cities, counties, and some special purpose districts may impose sales taxes up to an additional two percent. The total sales tax rate can't exceed 8.25 percent in any area. House Bill 157 leaves all of those limits in place, but it authorizes a city to hold an election to *reallocate sales tax revenue within the two percent local sales tax cap.* In a nutshell, the bill allows a city to assess its funding priorities and reallocate the distribution of its general and dedicated sales taxes, so long as the total local tax rate does not exceed two percent.

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. House Bill 157 changes that. When the bill becomes effective on September 1, cities will be able to call an election to increase or decrease their general sales tax rate in any increment of one-eighth of one percent.

House Bill 157 also gives cities the ability to adjust the rates of some of their dedicated sales taxes. In contrast to the general revenue sales tax, the revenue from which can be used for almost any purpose, cities also are authorized to hold elections to adopt sales taxes that may only be used for specific, dedicated purposes. Under current law, these dedicated sales taxes are capped at certain amounts. For instance, an economic development corporation sales tax may not exceed one-half of one percent. Similarly, the street maintenance sales tax may not exceed one-fourth of one percent. House Bill 157 essentially removes the current 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.

How might the bill benefit your city? Let's say a city currently has a general revenue sales tax of one percent, a Type B economic development corporation sales tax of one-half of one percent, a street maintenance sales tax of one-fourth of one percent, and a sales tax for property tax relief of one-fourth of one percent. That's a combined sales tax rate of 8.25 percent (6.25 percent for the state, and 2 percent for the city). When the bill becomes effective, the city could call a special election to reallocate all of those city sales taxes in a way that might make more financial sense. The city may wish to hold an election, for instance, to have the entire two percent go towards general revenue and repeal all other dedicated sales taxes. Alternatively, the city could have an election to have one percent go towards general revenue, and the remaining one percent going to property tax relief. Or the city could have a ballot proposition to repeal the street maintenance sales tax and have the one-fourth of one percent be dedicated towards the economic development corporation.

(Note that H.B. 157 gives cities the ability to hold an election to reallocate or adopt *city* sales taxes. Local sales taxes that have been adopted by other local governments that have overlapping jurisdiction with a city cannot be repealed or reallocated by city action.)

House Bill 157 passed both houses of the Texas Legislature with very little fanfare and minimal opposition. Despite the relative lack of attention paid to it throughout the session, it will likely be considered as one of the most beneficial city bills in recent years

H.B. 157 and Local Economic Development Initiatives

A previous issue of the *Legislative Update* reported on the passage of H.B. 157 and how it provides greater flexibility in how a city allocates its sales tax revenue. The bill gives city officials more flexible economic development options.

A common misconception is that local economic development incentives can be offered only through a Type A or Type B economic development corporation (EDC). City officials often believe that the EDC is their primary tool, and that the city council plays no other role in recruiting new businesses to the city. In actuality, city councils have far greater flexibility to offer incentives to a prospective business than does an EDC.

State law limits EDC dedicated sales tax expenditures to projects that fall within a fairly narrow set of "authorized projects," and only if approved by both the EDC board and the city council. EDC expenditures are limited to projects related to "primary jobs," infrastructure projects that directly develop business enterprises, and a handful of other permissible expenditures. (Only Type B EDCs of a certain size can spend EDC revenue on retail development.)

City councils, on the other hand, may – among other things – take action to offer property tax abatements, adopt property tax exemptions for certain goods-in-transit, build necessary public infrastructure through tax increment financing, rebate local sales taxes to retail businesses, waive certain taxes and fees through the creation of neighborhood empowerment zones, and – most significantly – provide economic development grants and loans to business prospects under a program adopted pursuant to Chapter 380 of the Local Government Code.

How does H.B. 157 fit in with all of this? Prior to the passage of H.B. 157, cities could hold an election to adopt a one percent general revenue sales tax, no higher and no lower. Cities could also hold elections to adopt dedicated sales taxes, like the sales tax for street maintenance, sales tax for property tax relief, and EDC sales tax. Just as cities were limited to one percent for the general revenue sales tax, cities also had maximum rates for dedicated sales taxes. For instance, prior to H.B. 157, the maximum rate for a Type A or Type B EDC sales tax was one-half of one percent.

Now that H.B. 157 has been signed into law, cities may hold elections to adopt sales taxes (general revenue or dedicated) in any increment of one-eighth of one percent, so long as the total city sales tax does not exceed the maximum two-percent local sales tax cap. In other words, cities now have increased flexibility to reallocate city sales taxes in a way that makes sense to the city and its residents. With regard to economic development, the bill means that cities can now explore how to best use sales tax revenue for economic development purposes.

Take, for instance, a city that has a one percent general revenue sales tax, a half-percent sales tax for a Type A EDC, and a half-percent sales tax for a Type B EDC. That city council can now at least review whether it makes sense to dedicate half of its total sales tax revenue to the two EDCs when the city can instead hold an election to reclaim some or all of that sales tax revenue for general purposes. If the voters replaced some of the EDC sales tax with the general revenue sales tax, the city council would have the discretion to informally dedicate any portion of the new general sales tax revenue to a economic development program where the money can be used for Chapter 380 grants and loans, which is a much broader incentive tool than is an EDC.

Essentially, H.B. 157 allows cities the option of both broadening and streamlining their economic development programs. In contrast to the somewhat restrictive EDC model of economic development, a city council has broad authority to enter into 380 economic development agreements with a business prospect if it believes an incentive will promote economic development and stimulate business and commercial activity in the city. By potentially freeing up sales tax revenue that is currently dedicated for specified purposes, H.B. 157 could help cities reimagine more effective and efficient local economic development programs.