

# **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.

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# **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 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 lowered 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.<sup>1</sup>

## **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 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 certain nonprofit entity temporary event permits, the holder of a private club registration permit, or the holder of certain retailer late hours certificates.<sup>2</sup>

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.

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<sup>1</sup> TEX. TAX CODE § 183.051(b).

<sup>2</sup> TEX. ALCO. BEV. CODE § 1.04.

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.<sup>3</sup> The city receives “no less” than a 10.7143 percent share of the 6.7 percent state tax.<sup>4</sup> That works out to roughly .72 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.<sup>5</sup> 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 percent share of the 8.25 percent tax.<sup>6</sup> That works out to roughly .88 percent 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?**

As mentioned above, cities receive a 10.7143 percent share of the mixed beverage gross receipts tax, in addition to a 10.7143 percent share of the new 8.25 percent mixed beverage sales tax. In 2022, that amounted to \$140.2 million in the aggregate for cities.

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<sup>3</sup> TEX. TAX CODE § 183.021.

<sup>4</sup> Id. § 183.051(b).

<sup>5</sup> Id. § 183.041.

<sup>6</sup> Id. § 183.051(b).

## **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<sup>7</sup>; to pay professional services; to pay operating expenses; or to pay off cash flow deficits.<sup>8</sup> A city may not use proceeds of an anticipation note to repay interfund or other borrowing that occurred earlier than 24 months before the date of the ordinance or order authorizing the issuance of the note.<sup>9</sup>

### **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.<sup>10</sup>

### **By what method may the city council issue anticipation notes?**

The city council must adopt an ordinance to authorize the issuance of anticipation notes.<sup>11</sup>

### **Are anticipation notes subject to attorney general approval?**

Yes. All public securities, unless specifically excepted, must receive attorney general approval.<sup>12</sup>

### **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.<sup>13</sup> Anticipation notes used

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<sup>7</sup> "Public work" is defined in TEX. GOVT' CODE § 271.043 (7-a)

<sup>8</sup> TEX. GOVT' CODE § 1431.004(a).

<sup>9</sup> Id. § 1431.005.

<sup>10</sup> Id. § 1431.007.

<sup>11</sup> Id. § 1431.002(b).

<sup>12</sup> Id. § 1202.003.

<sup>13</sup> Id. § 1431.009(a).

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.<sup>14</sup> 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.<sup>15</sup>

### **Can anticipation notes be used for emergency financing?**

A city located within 70 miles of the Gulf of Mexico or of a bay or inlet of the gulf may authorize the issuance of an anticipation note or other obligation in the event of widespread or severe damage, injury, or loss of life or property in a city resulting from a hurricane or tropical storm.<sup>16</sup> Following the emergency authorization of an anticipation note or other obligation, the city must submit to the attorney general for expedited review a transcript of proceedings related to the debt issuance.<sup>17</sup> Anticipation notes issued under these emergency provision must mature before the 10th anniversary of the date the attorney general approved the note or other obligation.

## **ASSET FORFEITURE FUNDS**

### **What is asset forfeiture?**

Chapter 59 of the Code of Criminal Procedure allows for police seizure and forfeiture of property used in the commission of certain crimes as well as proceeds gained from said criminal activity. After seizure, the district attorney may, by agreement, distribute property and funds to local law enforcement agencies to be used for authorized purposes.<sup>18</sup> 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...

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<sup>14</sup> Id. § 1431.009(c).

<sup>15</sup> Id. § 1431.010.

<sup>16</sup> Id. § 1431.015.

<sup>17</sup> Id. § 1431.017.

<sup>18</sup> TEX. CRIM. PROC. CODE §§ 59.01and 59.06.

(2) a special fund in the municipal treasury if distributed to a municipal law enforcement agency, to be used solely for law enforcement purposes[.]<sup>19</sup>

### **How can a city spend asset forfeiture funds?**

“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;
- (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.<sup>20</sup>

### **How can a city NOT spend asset forfeiture funds?**

State law 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.<sup>21</sup>

Additionally, a police department is prohibited from using forfeited 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.<sup>22</sup>

### **Who decides how asset forfeiture money is spent?**

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<sup>19</sup> Id. § 59.06(c) (emphasis added).

<sup>20</sup> Id. § 59.06(d-3).

<sup>21</sup> Id. § 59.06(d-1).

<sup>22</sup> Id. §§ 59.06(d-1)(2) and (d-2).



The police chief has sole decision-making authority on how asset forfeiture money is 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.<sup>23</sup>

### **Where must asset forfeiture money be kept?**

State law plainly provides that the forfeited funds are held in the municipal treasury.<sup>24</sup> It would be improper for the police chief to hold these funds in a separate institution from the 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.

A city may transfer up to 10 percent of the gross amount credited to the city's asset 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.<sup>25</sup> The city police department shall administer this separate special fund.<sup>26</sup>

### **If the council cannot 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 or disapprove of the actual expenditures.<sup>27</sup> The one instance in which the statute requires the city council to approve the use of asset 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.<sup>28</sup>

### **May the city conduct an audit of the asset forfeiture funds?**

Yes. Not only is the city council permitted to audit the police department asset forfeiture funds and expenditures, but it is required to do so annually. Expenditures of asset forfeiture proceeds are

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<sup>23</sup> Id. § 59.06(d) (emphasis added).

<sup>24</sup> Id. § 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).

<sup>25</sup> TEX. CRIM. PROC. CODE § 59.06(r).

<sup>26</sup> Id. § 59.06(r).

<sup>27</sup> Id. § 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).

<sup>28</sup> TEX. CRIM. PROC. CODE § 59.06(d-1)(7).

subject to audit provisions established in the Code of Criminal Procedure.<sup>29</sup> 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 representing the state to the attorney general not later than the 30<sup>th</sup> day after the date on which the annual period that is the subject of the audit ends.<sup>30</sup>

### **Must the police chief be given check-writing privileges over asset 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.<sup>31</sup> Most cities, however, adopt alternate procedures.

With asset forfeiture funds, the answer is different. The attorney general has concluded that a sheriff has sole check-writing authority, subject only to the statutory requirement that the agency submit a budget for that category of expenditure.<sup>32</sup> Because of the similarities between city and county forfeiture law and check-writing procedures, it is likely that this opinion is applicable to city asset forfeiture funds as well. As a result, the police chief may likely be the sole signatory on checks drawn from the forfeiture fund.

## **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

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<sup>29</sup> Id. § 59.06(d).

<sup>30</sup> Id. § 59.06(g).

<sup>31</sup> TEX. LOC. GOV'T CODE § 105.074

<sup>32</sup> Op. Tex. Att’y Gen. No. DM-247 (1993).

without simultaneously providing a tax to repay the debt and creating an interest and sinking fund<sup>33</sup> of two percent per year.<sup>34</sup>

### **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.<sup>35</sup> 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.<sup>36</sup> 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.<sup>37</sup> 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.

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<sup>33</sup> A sinking fund is a fund containing money set aside or saved to pay off a debt.

<sup>34</sup> TEX. CONST. art. 11, §§ 5 and 7.

<sup>35</sup> Op. Tex. Att'y Gen. No. JC-0139 (1999).

<sup>36</sup> *Mitchell County v. City Nat. Bank*, 43 S.W. 880 (1898).

<sup>37</sup> TEX. LOC. GOV'T CODE § 101.005(c).

## **BINGO PRIZE FEES**

### **What are bingo prize fees?**

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 and updated in 2023 reconfigures how cities and counties receive bingo prize fee revenue.<sup>38</sup> 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.<sup>39</sup> The organization then must remit 50 percent of the fee revenue to the Texas Lottery Commission, and the other 50 percent in equal shares to the applicable city and 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.<sup>40</sup> 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.<sup>41</sup>

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.

## **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.

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<sup>38</sup> TEX. OCC. CODE §§ 2001.502(a)-(d), 2001.504(a) (as added by H.B. 914 of the 86<sup>th</sup> Leg. R.S. (Effective Sept. 1, 2019); Id. § 2001.502(b) and (c) (as amended by S.B. 643 of the 88<sup>th</sup> Leg. R. S. Effective Sept. 1, 2023).

<sup>39</sup> Id. § 2001.502(a).

<sup>40</sup> Id. § 2001.502(b).

<sup>41</sup> Id. § 2001.502(c).

## **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 percent (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.<sup>42</sup>

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

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<sup>42</sup> 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.<sup>43</sup>

Revenue bonds that are not payable from any taxes need not be submitted to the voters for approval under state law.<sup>44</sup> 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.<sup>45</sup>

### **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.<sup>46</sup>

### **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”.<sup>47</sup> 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?**

No, revenue bonds are not considered debts under the Texas Constitution.<sup>48</sup>

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<sup>43</sup> TEX. GOV'T CODE §1251.001.

<sup>44</sup> *Atkinson v. City of Dallas*, 353 S.W.2d 275 (Tex.Civ.App.--Dallas 1961, writ ref'd n.r.e.).

<sup>45</sup> TEX. GOV'T CODE §1202.003.

<sup>46</sup> Id. §1202.004.

<sup>47</sup> Id. §1202.006.

<sup>48</sup> *Atkinson v. City of Dallas*, 353 S.W.2d 275 (Tex.Civ.App.--Dallas 1961, writ ref'd n.r.e.).

### **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.<sup>49</sup>

### **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?**

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<sup>49</sup> 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;<sup>50</sup> (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.<sup>51</sup> 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.<sup>52</sup>

### **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.<sup>53</sup>

### **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.<sup>54</sup>

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).<sup>55</sup> 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 roughly 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 property tax rate to pay the debt; thus, it provides some political "cover" to have voter approval in the first place.

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<sup>50</sup> TEX. LOC. GOV'T CODE § 271.043 (7-a).

<sup>51</sup> Id. § 271.045.

<sup>52</sup> Id. § 271.049.

<sup>53</sup> Id. § 271.044; *see also* TEX. LOC. GOV'T CODE § 51.051(b).

<sup>54</sup> Id. § 271.049(c).

<sup>55</sup> 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).

### **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.<sup>56</sup> 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.<sup>57</sup>

### **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 45<sup>th</sup> day before the date tentatively set for the passage of the ordinance authorizing the issuance of the COs.<sup>58</sup> 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.<sup>59</sup>

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.<sup>60</sup>

### **Must COs receive attorney general approval?**

COs issued directly to a contractor need not receive attorney general approval.<sup>61</sup> All other COs must receive attorney general approval.<sup>62</sup>

### **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.<sup>63</sup>

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<sup>56</sup> TEX. LOC. GOV'T CODE § 271.047(d).

<sup>57</sup> Id. § 271.047(d).

<sup>58</sup> Id. § 271.049(a).

<sup>59</sup> Id.

<sup>60</sup> Id. § 271.049(b)(4).

<sup>61</sup> TEX. GOV'T CODE § 1202.007(a)(3).

<sup>62</sup> Id. § 1202.003(a).

<sup>63</sup> TEX. LOC. GOV'T CODE § 271.044(b).

## **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.<sup>64</sup>

## **CHILD SAFETY FINES**

### **What are child safety fines?**

Cities under 1.3 million population may adopt an optional municipal court fine on parking violations, if the city has a parking ordinance that provides penalties for violations.<sup>65</sup> 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.<sup>66</sup>

Cities with populations greater than 1.3 million that adopt a municipal court fine on parking violations must levy the fine in an amount between \$2 and \$5.<sup>67</sup>

### **How is the child safety fine adopted?**

A city council adopts the child safety fine by “order.”<sup>68</sup> An order is similar to a resolution.

### **What can the proceeds of the fine be spent on?**

**Cities under 1.3 million 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 expend it for programs designed to enhance child safety, health, or nutrition, including child abuse prevention and intervention, youth diversion,<sup>69</sup> and drug and alcohol abuse prevention.<sup>70</sup> A city under 1.3 million population is also authorized to spend the additional money on programs designed to enhance public safety and security.<sup>71</sup>

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<sup>64</sup> Id. § 271.050(b).

<sup>65</sup> TEX. CRIM. PROC. CODE § 102.014(b) (as amended by H.B. 4559 of the 88th Leg. R.S. Effective Sept. 1, 2023).

<sup>66</sup> Id.

<sup>67</sup> Id. § 102.014(a) (as amended by H.B. 4559 of the 88th Leg. R.S. Effective Sept. 1, 2023).

<sup>68</sup> Id. § 102.014(b).

<sup>69</sup> Id. § 102.014(g) (as added by H.B. 3186 of the 88th Leg. R.S. Effective Jan. 1, 2024).

<sup>70</sup> Id.

<sup>71</sup> Id.

**Cities over 1.3 million population:** The city must deposit the proceeds of the fine into the required municipal child safety trust fund created under Chapter 106 of the Local Government Code.<sup>72</sup> Money in that fund is to be spent on school crossing guard programs, and any remaining funds may be used for other child safety and health initiatives, including child abuse intervention and prevention and drug and alcohol use prevention.<sup>73</sup>

**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.<sup>74</sup>

## **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.<sup>75</sup>

**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.”<sup>76</sup>

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

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.<sup>77</sup>

**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.

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<sup>72</sup> TEX. CRIM. PROC. CODE § 102.014(f).

<sup>73</sup> TEX. LOC. GOV’T CODE § 106.003.

<sup>74</sup> TEX. CRIM. PROC. CODE § 102.014(c).

<sup>75</sup> TEX. OCC. CODE § 2153.451(a).

<sup>76</sup> Id. § 2153.002(1).

<sup>77</sup> Id. §§ 2153.451(b) and 2153.401(b).

## **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.<sup>78</sup>

**How is a credit card reimbursement fee adopted?**

The amount of the fee is set by city council.<sup>79</sup> 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.<sup>80</sup> In 2019, the attorney general opined that vendors contracting with a governmental entity may also, in certain circumstances, collect credit card reimbursement fees on behalf of the governmental entity.<sup>81</sup>

## **DONATIONS**

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

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 express authority to accept gifts or donations. For implied authority, 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.<sup>82</sup> 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

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<sup>78</sup> TEX. LOC. GOV'T CODE § 132.002(b).

<sup>79</sup> Id. § 132.002(b).

<sup>80</sup> Id.

<sup>81</sup> Op. Tex. Att’y Gen. No. KP-0257 (2019).

<sup>82</sup> TEX. LOC. GOV'T CODE § 51.015(a).

on behalf of the county for the purpose of performing a function conferred by law on the county or a county officer.”<sup>83</sup>

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 a variety of public purposes.<sup>84</sup> Cities may also acquire by gift any object or collection of historic significance to the city.<sup>85</sup> 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.<sup>86</sup> 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.<sup>87</sup> 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.<sup>88</sup> 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 law<sup>89</sup>, 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.<sup>90</sup>

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?**

Maybe. A city is a “qualified entity” to which tax-deductible charitable donations may be made.<sup>91</sup> 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.

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<sup>83</sup> Id. § 81.032.

<sup>84</sup> Id. §§ 273.001 and 332.006.

<sup>85</sup> Id. § 331.002.

<sup>86</sup> Id. § 309.001.

<sup>87</sup> Op. Tex. Att’y Gen. No. GA-0562 (2007); *see also State v. Mauritz-Wells Co.*, 175 S.W.2d 238, 241 (Tex. 1943).

<sup>88</sup> TEX. LOC. GOV’T CODE § 51.0076(a).

<sup>89</sup> *Forwood v. City of Taylor*, 214 S.W.2d 282 (1948).

<sup>90</sup> *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.”).

<sup>91</sup> 26 U.S.C. § 170(c); Dep’t of the Treasury Internal Revenue Service, Charitable Contributions: Publication 526 at 3 (2020), available at <http://www.irs.gov/publications/p526>.

## 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.<sup>92</sup>

### **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). The Act contains the procedures and formalities a city must follow to create a drainage utility for which a fee is permitted.

Cities that do not attempt to charge a fee for drainage 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?**

A city must do the following to establish a drainage utility:

#### **(1) Findings**

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

- a. The city intends to establish a schedule of drainage charges against all real property in the proposed service area of the utility;<sup>93</sup>
- b. The city will provide drainage for all real property in the proposed service area on payment of drainage charges, except for exempt property;<sup>94</sup> and
- c. The city will offer drainage service on nondiscriminatory, reasonable, and equitable terms.<sup>95</sup>

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<sup>92</sup> TEX. LOC. GOV’T CODE §§ 552.041 – 552.054.

<sup>93</sup> Id. § 552.045(b)(1).

<sup>94</sup> Id. § 552.045(b)(2).

<sup>95</sup> Id. § 552.045(b)(3).

**(2) Public Hearing on Drainage Ordinance**

The city must hold a public hearing to take public testimony on the proposed drainage system ordinance.<sup>96</sup> The city must publish notice of the hearing in the newspaper three times, the first time being on or before the 30th day before the hearing.<sup>97</sup>

**(3) Adopt Drainage Ordinance**

After the conclusion of the public hearing, the city council adopts an ordinance adopting Subchapter C of Chapter 552 of the Texas Local Government Code and declares the drainage of the city to be a public utility.<sup>98</sup>

**(4) Public Hearing on a Schedule of Charges**

After adoption of the ordinance above, the city should levy a schedule of drainage charges, consistent with the charge methodology found in the Act. Prior to the levy, the city must hold a hearing on the schedule of charges, and the city must publish notice of the hearing in the newspaper three times, the first time being on or before the 30th day before the hearing.<sup>99</sup> The published notices must contain the time and place of the hearing and contain the proposed schedule of charges.<sup>100</sup>

**(9) Adopt Drainage Charge Schedule**

After the public hearing, the city may adopt the schedule of drainage charges.

**(10) Adopt Other Rules**

Following creation of the drainage utility, the city council can adopt additional rules governing the drainage utility as the council considers necessary.<sup>101</sup>

**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.<sup>102</sup> A uniform drainage charge imposed solely for reason of administrative convenience would likely be improper, 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.<sup>103</sup>

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<sup>96</sup> Id. § 552.045(c).

<sup>97</sup> Id.

<sup>98</sup> Id. § 552.045(a).

<sup>99</sup> Id. § 552.045(d).

<sup>100</sup> Id.

<sup>101</sup> Id. § 552.045(e).

<sup>102</sup> Id. § 552.047.

<sup>103</sup> 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.<sup>104</sup>

### **What properties are exempt from drainage fees?**

Land owned by the state, a county, a municipality, a school district, or an open-enrollment charter school may be exempted from drainage charges.<sup>105</sup> 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.<sup>106</sup> Also, state agencies and public institutions of higher education are exempted from drainage fees.<sup>107</sup>

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.<sup>108</sup> 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.<sup>109</sup>

### **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 service<sup>110</sup>; or (3) prohibit usage of the drainage facility by the owner of the tract or lot (assuming this is possible).<sup>111</sup>

### **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.<sup>112</sup>

### **How must drainage fee proceeds be handled within the city's fund structure?**

Drainage fees must initially be segregated and accounted for separately within the city's accounting structure. Thereafter, proceeds of fees to cover current costs of service may be

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<sup>104</sup> TEX. LOC. GOV'T CODE § 552.054(3).

<sup>105</sup> Id. § 552.053(b); *see also* Tex. Att'y Gen. Op. No. GA-1080 (2014).

<sup>106</sup> Id. § 552.053(c).

<sup>107</sup> Id. § 580.003.

<sup>108</sup> Id. § 552.053(d).

<sup>109</sup> Id. § 552.053(d-1).

<sup>110</sup> Id. § 552.050.

<sup>111</sup> Id. § 552.047(d).

<sup>112</sup> Id. § 552.044(4).

transferred to the city's general fund, while other proceeds, including those used to pay for future construction, must remain segregated.<sup>113</sup>

## **GRANTS**

### **May a city be the recipient of grant money?**

Yes. 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.<sup>114</sup> 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 must follow.

### **What are park grants?**

State park grants are one of the few areas of state revenue that flows directly to cities. 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.<sup>115</sup>

### **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**

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<sup>113</sup> Id. § 552.049.

<sup>114</sup> TEX. LOC. GOV'T CODE § 102.009(b).

<sup>115</sup> TEX. CONST. art. 8, § 7-d; TEX. PARKS & WILD. CODE § 24.002.

### **What are hotel occupancy taxes?**

Hotel Occupancy Taxes (HOT taxes) are taxes levied on a person who 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.<sup>116</sup>

### **How much hotel occupancy taxes may a city levy?**

Generally speaking, a city may levy a HOT tax in any amount up to, and including, seven percent of the price paid for the room.<sup>117</sup> 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.<sup>118</sup> The price of the room does not include food and drink.<sup>119</sup>

### **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, bed-and-breakfasts, and short-term rentals.<sup>120</sup> It does not include, dormitories, hospitals, and nursing homes.<sup>121</sup>

### **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.<sup>122</sup> 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.<sup>123</sup> 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.<sup>124</sup>

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?**

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<sup>116</sup> TEX. TAX CODE § 351.002(a).

<sup>117</sup> Id. § 351.003.

<sup>118</sup> Id. §§ 351.003, 351.1055, 351.1065, and 351.107.

<sup>119</sup> Id. § 351.002(b).

<sup>120</sup> Id. § 156.001.

<sup>121</sup> Id. § 156.001.

<sup>122</sup> Id. § 351.0025(a).

<sup>123</sup> Id. § 351.0025(b).

<sup>124</sup> Op. Tex. Att’y Gen. No. GA-408 (2006).

A hotel occupancy tax must be levied by ordinance.<sup>125</sup> No election or other approval of the citizens is required.

### **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 rate in effect when the contract was executed, unless the contract is subject to change or modification by reason of the tax rate increase.<sup>126</sup>

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

Hotel occupancy tax revenue is “dedicated revenue,” and may only be spent on certain, statutorily defined purposes. Generally speaking, all expenditures of city hotel tax revenue must promote tourism within the city. This general rule can be further broken down into the following two-part test:

- (a) Does the expenditure promote tourism and the convention and hotel industry? (The question is often asked in the following way: Does the expenditure put “heads in beds?”); and
- (b) Does the expenditure 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 certain cities, including cities located 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; or

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<sup>125</sup> TEX. TAX CODE § 351.002(a).

<sup>126</sup> Id. § 351.007(a).

- (9) signage directing the public to sights and attractions that are visited frequently by hotel guests in the city.<sup>127</sup>

If the answer to parts (a) and (b) above are “yes,” HOT revenue can be used for the expenditures listed above.

Additionally, the Tax Code has some fairly specific provisions relating to how expenditures within the nine statutory categories should be allocated depending on the population of the city. Funding of the arts is generally limited to no more than fifteen percent of total tax revenue, and a certain portion must be spent on promoting the city and/or on convention facilities, again depending on the size of the city.<sup>128</sup>

### **Can a city fund a fireworks show (or similar events) using hotel occupancy taxes?**

All HOT fund expenditures must pass the “two-part test” above.

*Part 1:* Does a fireworks show put heads in beds? The likely answer is no.

*Part 2:* Additionally, even if fireworks show attracted overnight tourists to the city, fireworks expenditures do not 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 that attracts tourists to the city” literally means some sort of print or other media that explicitly promotes the city. Thus, direct funding of a fireworks show 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 visitor bureau so long as the chamber or other entity spends the money on projects that otherwise meet the two-part test mentioned above. There must be a written contract laying out the duties of the entity, and the entity must keep the hotel taxes in an account separate from the general operating fund.<sup>129</sup>

### **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.<sup>130</sup> 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?**

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<sup>127</sup> Id. § 351.101.

<sup>128</sup> Id. § 351.103.

<sup>129</sup> Id. § 351.101(c).

<sup>130</sup> Id. § 156.052.

The following remedies are available against hotels that fail to 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.<sup>131</sup> If an audit conducted by the city shows a concurrent delinquency is 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.<sup>132</sup>

### **Are cities required to annually report hotel occupancy tax information?**

Yes. Cities are required to annually report hotel occupancy tax information to the comptroller.<sup>133</sup> Not later than March 1 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; (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; and (4) the amount of revenue collected in any preceding fiscal year that has not yet been spent and the amount of that revenue remaining in the city’s possession.<sup>134</sup> 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.<sup>135</sup> A city is permitted to use a portion of the hotel occupancy tax revenue to offset the costs of the required reporting in the amount of \$1000 for a city with a population under 10,000 and \$2,500 if the city has a population 10,000 or more.<sup>136</sup> The reporting form and historical data can be found at: <https://comptroller.texas.gov/transparency/local/hotel-receipts>.

## **IMPACT FEES**

Cities may 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 the fees.

### **What are impact fees?**

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<sup>131</sup> Id. § 351.004.

<sup>132</sup> Id. § 351.008.

<sup>133</sup> Id. § 351.009.

<sup>134</sup> Id. § 351.009(a) (as amended by H.B. 3727 of the 88th Leg. R.S. Effective June 12, 2023).

<sup>135</sup> Id. § 351.009(b).

<sup>136</sup> Id. § 351.009(b) (as added by H.B. 3727 of the 88th Leg. R.S. Effective June 12, 2023).

Impact fees are defined 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.”<sup>137</sup>

Put simply, impact fees are a mechanism by which cities charge property developers for some of the cost that new development places on the infrastructure and resources of a city.

### **How can cities spend impact fee revenue?**

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.<sup>138</sup>
- (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).<sup>139</sup>

### **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.<sup>140</sup>

### **What is the procedure for adopting an impact fee?**

Adoption of an impact fee requires compliance with several detailed steps, and strict compliance with each step is strongly recommended, lest the city open itself up to potential litigation. If your

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<sup>137</sup> TEX. LOC. GOV’T CODE § 395.001(4).

<sup>138</sup> Id. § 395.001(1).

<sup>139</sup> Id. § 395.012.

<sup>140</sup> Id. § 395.013.

city wishes to adopt impact fees or update its impact fees, involve your professionals early, including your local attorney. The following is a summary of the procedural steps:

- (1) **Appoint 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).<sup>141</sup>

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.<sup>142</sup>

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.<sup>143</sup>

- (2) **Draft Capital Improvements Plan and Land Use Assumptions.** The city must prepare a draft of its "land use assumptions."<sup>144</sup> Land use assumptions are essentially documentation containing projections of changes in land uses, densities, intensities, and population in the designated service area (defined as the area served by the facilities funded by the impact fee) over at least a 10-year period.<sup>145</sup> Based on the projections contained in the land use assumptions, the city also prepares a draft of a capital improvements plan (CIP), detailing the capital improvements that will need to be made over the term of the plan to meet existing and projected future needs. The CIP must be developed by qualified professionals using generally accepted engineering and planning practices.<sup>146</sup> The land use assumptions and CIP are detailed documents that form the basis for calculating permissible impact fees.
- (3) **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.<sup>147</sup> Proper notice of the hearing must be given at least 31 days in advance of the hearing.<sup>148</sup>

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<sup>141</sup> Id. § 395.058(a).

<sup>142</sup> Id. § 395.058(b).

<sup>143</sup> Id. § 395.058(c) and 395.050.

<sup>144</sup> Id. § 395.042.

<sup>145</sup> Id. § 395.001(5).

<sup>146</sup> Id. § 395.0411.

<sup>147</sup> Id. § 395.042.

<sup>148</sup> Id. § 395.044.



- (4) **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.
- (5) **Vote to Adopt an Ordinance Approving the CIP and Land Use Assumptions.** After the conclusion of the hearing, the council should “determine whether to adopt or reject an ordinance, order, or resolution approving the land use assumptions and capital improvements plan.”<sup>149</sup>

Whether this “determination” step must be a distinct requirement from simply adopting the CIP and land use assumptions is debatable. Regardless, within 30 days after the hearing, the city council must adopt an ordinance, order, or resolution approving the CIP and land use assumptions.<sup>150</sup>

- (6) **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 setting a public hearing to discuss the imposition of the impact fee.<sup>151</sup> Proper notice of the hearing must be given at least 31 days in advance of the hearing.<sup>152</sup>
- (7) **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.<sup>153</sup>
- (8) **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.
- (9) **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.<sup>154</sup>
- (10) **Five-Year Review.** A city imposing impact fees must hold hearings and update the CIP and land use assumptions at least every five years.<sup>155</sup> Chapter 395 of the Local Government Code contains detailed procedures for hearings, review, and amendment of the CIP.<sup>156</sup>

### Where may impact fees be assessed?

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<sup>149</sup> Id. § 395.045(a).

<sup>150</sup> Id. § 395.045(b).

<sup>151</sup> Id. § 395.047.

<sup>152</sup> Id. § 395.049.

<sup>153</sup> Id. § 395.050.

<sup>154</sup> Id. § 395.051.

<sup>155</sup> Id. § 395.052.

<sup>156</sup> Id. §§ 395.053-395.0575.

Any type of impact fee authorized by Chapter 395 may be imposed within the corporate limits of a city.<sup>157</sup> 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.<sup>158</sup> In areas outside both the corporate boundaries and ETJ, the city may only impose impact fees by contract (but not for roadway facility fees).<sup>159</sup>

### **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.<sup>160</sup> 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.

### **When may an impact fee be collected from a developer?**

Generally, impact fees are assessed on development at the time the final plat of the property is recorded.<sup>161</sup> Impact fees are generally collected when a building permit is issued.<sup>162</sup> The statute has different assessment and collection timing based on when the impact fees were adopted, so please consult the language of the law before taking final action.

### **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.<sup>163</sup>

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

Yes, impact fees may be pledged to pay bonds and other notes, provided the improvement being paid for is identified in the CIP.<sup>164</sup> 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.<sup>165</sup>

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<sup>157</sup> Id. § 395.011(b).

<sup>158</sup> Id.

<sup>159</sup> Id. § 395.011(c).

<sup>160</sup> Id. § 395.015.

<sup>161</sup> Id. § 395.016.

<sup>162</sup> Id.

<sup>163</sup> Id. § 395.016(c).

<sup>164</sup> Id. § 395.012(d)(1).

<sup>165</sup> Id. § 395.012(d)(2).

**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.<sup>166</sup>

## **INTERLOCAL AGREEMENTS**

**What are interlocal agreements?**

Contracts between a city and other units of local government or the state for goods or services are known as interlocal agreements and are governed by Chapter 791 of the Texas Government Code.

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<sup>166</sup> Id. § 395.001(4).

### **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 to provide governmental functions or services that each party to the contract is authorized to perform individually.<sup>167</sup> Governmental functions are defined in the act to include the following: 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.<sup>168</sup>

### **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.<sup>169</sup> 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.

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 state the following:

- (1) the purpose, terms, rights, and duties of the contracting parties; and

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<sup>167</sup> TEX. GOV’T CODE § 791.011(c).

<sup>168</sup> Id. § 791.003(3).

<sup>169</sup> Id. § 791.011(c)(2).

- (2) that each party paying for the performance of governmental functions or services must make those payments from current revenues available to the paying party.<sup>170</sup>

**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.<sup>171</sup>

**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. The Texas Constitution 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.<sup>172</sup> This gives 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.<sup>173</sup> However, a city may not charge a fee to accept a communication related to property tax delivered electronically to the city.<sup>174</sup>

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

A fee must be “reasonable.”<sup>175</sup> 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.<sup>176</sup>

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<sup>170</sup> Id. § 791.011(d).

<sup>171</sup> Id. § 791.011(e).

<sup>172</sup> TEX. CONST. art. 11, §§ 5(b) and 7(b).

<sup>173</sup> TEX. LOC. GOV'T CODE § 132.007.

<sup>174</sup> TEX. TAX CODE § 1.085(a-4) (as added by H.B. 1228 of the 88th Leg. R.S. Effective Jan. 1, 2024).

<sup>175</sup> TEX. LOC. GOV'T CODE § 132.007(b).

<sup>176</sup> Id. § 132.007(c).

# **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) The city must adopt a written investment policy;
- (2) The 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?**

The governing body of a city shall adopt by ordinance or resolution, a written investment policy regarding the investment of its funds and funds under its control.<sup>177</sup> 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.<sup>178</sup> If the policy applies to the financial assets of all funds or fund types, that fact should be clearly stated. A 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.<sup>179</sup> 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.<sup>180</sup>

As part of the policy, the city must adopt separate written investment strategies for each of the funds under its control. While the yield associated with an investment is important for revenue generation, it is actually the lowest priority a city should consider when drafting an investment

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<sup>177</sup> TEX. GOV'T CODE §2256.005(a).

<sup>178</sup> Id. § 2256.005(b)(2).

<sup>179</sup> Id. § 2256.005(b)(4)(a) & (c).

<sup>180</sup> Id. § 2256.005(b)(4)(d) & (f).

strategy.<sup>181</sup> The first priority for consideration is the suitability of the investment to the overall cash flow and financial requirements of the entity followed by safety of the principal and liquidity.<sup>182</sup> Public officials have a fiduciary responsibility to manage and maintain taxpayer funds, and the PFIA requires governing bodies of local governments to invest public funds with the same prudence, discretion, and intelligence one would use to manage their personal affairs.<sup>183</sup>

The PFIA requires that the governing body of an investing entity review its investment policy at least once a year.<sup>184</sup> Moreover, the governing body must take formal action stating that the policy and strategy have been reviewed and record any changes to either the policy or investment strategy. 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.<sup>185</sup> 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?**

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.<sup>186</sup> The PFIA is written in a way that requires all cities to appoint someone to one of these positions 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.<sup>187</sup>

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](http://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:

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<sup>181</sup> Id. §2256.005(d).

<sup>182</sup> Id.

<sup>183</sup> Id. §2256.006

<sup>184</sup> Id. §2256.005(e).

<sup>185</sup> Id. §2256.005(f).

<sup>186</sup> Id. §2256.008.

<sup>187</sup> Id. §2256.008(a-1).

- (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.<sup>188</sup>
- (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.<sup>189</sup> CDs must be collateralized (secured) for amounts greater than FDIC insurance (\$250,000).
- (3) **Repurchase Agreements.** Certain fully-collateralized repurchase agreements are legal investments.<sup>190</sup>
- (4) **Securities Lending Programs.**<sup>191</sup>
- (5) **Banker’s Acceptances.**<sup>192</sup>
- (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.<sup>193</sup>
- (7) **Certain Mutual Funds.**<sup>194</sup> (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.<sup>195</sup>
- (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”.<sup>196</sup> 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.<sup>197</sup>
- (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.<sup>198</sup>
- (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.

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<sup>188</sup> Id. §2256.009.

<sup>189</sup> Id. §2256.010.

<sup>190</sup> Id. §2256.011.

<sup>191</sup> Id. §2256.0115.

<sup>192</sup> Id. §2256.012.

<sup>193</sup> Id. §2256.013.

<sup>194</sup> Id. §2256.014.

<sup>195</sup> Id. §2256.015.

<sup>196</sup> Id. §2256.016.

<sup>197</sup> Id.

<sup>198</sup> Id. §2256.0201.



- (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.<sup>199</sup> Before investing in a hedging transaction, the governing body of an eligible entity must first establish the entity's policy regarding hedging transactions.<sup>200</sup>

### **May a city invest in corporate stocks?**

No. Stock in private corporations is not included among the authorized investments under the PFIA.

### **Which mutual funds may a city invest in?**

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 investment<sup>201</sup>:

- (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);

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<sup>199</sup> Id. §2256.0206(a).

<sup>200</sup> Id. §2256.0206(c)

<sup>201</sup> Id. § 2256.014.

- (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.<sup>202</sup>

**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 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 non-jailable misdemeanor.<sup>203</sup> 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 youth diversion fund regardless of whether the city formally adopted the fee. The city is responsible for collecting the fee and establishing four different accounts to which the fee revenue is assigned.

The fee revenue must be apportioned as follows:

- (1) 35.7143 percent (\$5.00 of each fee) to the Local Youth 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

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<sup>202</sup> Id. § 2256.010.

<sup>203</sup> TEX. LOC. GOV'T CODE § 134.103(a).

(4) .7143 percent (\$.10) to the Municipal Jury Fund.<sup>204</sup>

**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.<sup>205</sup> Thus, most routine dispositions of criminal cases in municipal court, short of acquittal or dismissal, trigger the local consolidated court fee.

**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.<sup>206</sup>

**What may money in the local youth diversion fund be spent on?**

A city that employs or contracts with a juvenile case manager may use money in the local youth 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.<sup>207</sup> 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.<sup>208</sup>

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

A city that does not employ or contract with a juvenile case manager may, in consultation with the court, direct money in the local youth diversion fund to be used for the support of a local mental health authority, juvenile alcohol and substance abuse programs, educational and leadership programs, teen court programs, and any other project designed to prevent or reduce the number of juvenile referrals to the court.<sup>209</sup>

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

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<sup>204</sup> Id. § 134.103(b).

<sup>205</sup> Id. § 134.002(b).

<sup>206</sup> Id. §§ 134.002(a)(2) and 134.0051.

<sup>207</sup> Id. § 134.156(a).

<sup>208</sup> Id.

<sup>209</sup> Id. § 134.156(a-1) (as added by H.B. 3186 of the 88th Leg. R.S. Effective Jan. 1, 2024).

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;
- (2) Handheld metal detectors;
- (3) Walkthrough metal detectors;
- (4) Identification cards and systems;
- (5) Electronic locking and surveillance equipment;
- (6) Video conferencing 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.<sup>210</sup>

#### **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.<sup>211</sup>

#### **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.<sup>212</sup>

## **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.

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<sup>210</sup> TEX. CRIM. PROC. CODE § 102.017(c).

<sup>211</sup> Id. § 102.0172(b).

<sup>212</sup> TEX. LOC. GOV'T CODE § 134.154.

### **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.<sup>213</sup>

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.<sup>214</sup> 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.<sup>215</sup>

### **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.<sup>216</sup>

### **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, keeping in mind the federal and state protections against “excessive fines.”<sup>217</sup>

See Chapter: *Traffic Fine Revenue*

## **MUNICIPAL DEVELOPMENT CORPORATION SALES** **TAX**

### **What is a municipal development corporation?**

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<sup>213</sup> TEX. TRANSP. CODE § 542.401.

<sup>214</sup> TEX. LOC. GOV'T CODE § 54.001(b).

<sup>215</sup> Id.

<sup>216</sup> TEX. TRANSP. CODE § 542.402(a).

<sup>217</sup> See TEX. CONST. art. I, § 13; U.S. CONST. amend. VIII; Op. Tex. Att’y Gen. KP-0267 (2019).

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.<sup>218</sup> The sales tax may be levied at the rate of one-eighth, one-fourth, three-eighths, or one-half of one percent.<sup>219</sup> The tax must be reauthorized every 20 years.<sup>220</sup>

### **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.<sup>221</sup>

### **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.<sup>222</sup> A director may not be an employee or officer of the city that created the MDC.<sup>223</sup>

### **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.<sup>224</sup> The MDC’s budget that is presented to the city council must include a detailed description of proposed expenditures.<sup>225</sup> Further, two-thirds of the city council can vote to amend the MDC’s budget.<sup>226</sup> The MDC board must prepare annual financial statements

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<sup>218</sup> TEX. LOC. GOV’T CODE § 379A.081(a).

<sup>219</sup> Id. § 379A.081(e).

<sup>220</sup> Id. § 379A.081(d).

<sup>221</sup> Id. § 379A.051(a).

<sup>222</sup> Id. § 379A.021.

<sup>223</sup> Id. § 379A.021(e).

<sup>224</sup> Id. § 379A.025(a).

<sup>225</sup> Id. § 379A.025(c).

<sup>226</sup> Id. § 379A.025(b).

to be presented to the city council, and the city council is entitled to the records of the MDC at all times.<sup>227</sup>

### **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.<sup>228</sup> 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.<sup>229</sup> 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.<sup>230</sup> *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.

### **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.<sup>231</sup> The combined rate of all local sales taxes within the district, however, cannot exceed two percent.<sup>232</sup>

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<sup>227</sup> *Id.* §§ 379A.025(d) and (e).

<sup>228</sup> *Id.* § 379A.081(c).

<sup>229</sup> *Id.* §§ 377.021 and 377.022.

<sup>230</sup> *Id.* § 377.101.

<sup>231</sup> *Id.* § 377.104.

<sup>232</sup> *Id.* § 377.101(c).

### **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.<sup>233</sup> 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.<sup>234</sup>
- (3) Parking lots for such convention or related facilities.<sup>235</sup>
- (4) Civic center hotels.<sup>236</sup> 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.<sup>237</sup>

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 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);

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<sup>233</sup> Id. § 377.001(3)(A).

<sup>234</sup> Id. § 377.001(3)(B).

<sup>235</sup> Id.

<sup>236</sup> Id.

<sup>237</sup> Id. § 377.002.



- (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.”<sup>238</sup> 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.<sup>239</sup> 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.<sup>240</sup> 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.<sup>241</sup> A Type B corporation has a seven-member board.<sup>242</sup> 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 limits with permission of the governing body that has jurisdiction over the property.<sup>243</sup> 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.)<sup>244</sup> 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.

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<sup>238</sup> Id. § 377.002(a)(1).

<sup>239</sup> Id. § 377.002(a)(2).

<sup>240</sup> Id. § 501.007(a).

<sup>241</sup> Id. § 377.051(a).

<sup>242</sup> Id. § 505.051.

<sup>243</sup> Id. § 501.159.

<sup>244</sup> Id. § 377.072(a).

**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.<sup>245</sup> 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.<sup>246</sup>

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.

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.<sup>247</sup>

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?**

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<sup>245</sup> Id. § 377.022.

<sup>246</sup> Id. § 377.001(3)(A).

<sup>247</sup> Id. §§ 505.156 and 505.158.

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.”;*<sup>248</sup> 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).<sup>249</sup>

- (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.<sup>250</sup>
- (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).<sup>251</sup>
- (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 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.<sup>252</sup>
- (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.<sup>253</sup> 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.<sup>254</sup>

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<sup>248</sup> Id. § 377.021(b).

<sup>249</sup> Id. § 377.021(g).

<sup>250</sup> Id. § 377.021(a).

<sup>251</sup> Id. § 377.021(g).

<sup>252</sup> Id. § 377.106.

<sup>253</sup> Id. § 377.051(c).

<sup>254</sup> Id. § 377.021(d).

- (6) **Establish Development Project Fund.** The board of the MDD then must pass a resolution establishing the “development project fund.”<sup>255</sup> 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.<sup>256</sup>

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 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.<sup>257</sup>

**OPEN RECORDS CHARGES**

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<sup>255</sup> Id. § 377.072(a).

<sup>256</sup> TEX. TAX CODE § 321.409(b).

<sup>257</sup> TEX. LOC. GOV’T CODE § 377.073.

## **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.<sup>258</sup>

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.<sup>259</sup>

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?**

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.<sup>260</sup> 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.<sup>261</sup>

## **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.<sup>262</sup>

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<sup>258</sup> TEX. GOV'T CODE § 552.261(a).

<sup>259</sup> Id.

<sup>260</sup> Id. § 552.2615(a).

<sup>261</sup> Id. § 552.2615(b).

<sup>262</sup> 1 TEX. ADMIN. CODE § 70.3.

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.<sup>263</sup>

### **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)<sup>264</sup>
- (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.<sup>265</sup>

### **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.<sup>266</sup> For example, the maximum charge for a DVD is \$3.00.<sup>267</sup>

## **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, 1,089 levy a property tax for general revenue.<sup>268</sup>

According to a recent survey conducted by TML, property taxes are the leading source of city revenue, accounting for 41 percent of city revenues on average statewide. Sales taxes are second at 29 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

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<sup>263</sup> TEX. GOV'T CODE § 552.261(b).

<sup>264</sup> Id. § 552.263(a).

<sup>265</sup> Id.

<sup>266</sup> TEX. GOV'T CODE § 552.262(a).

<sup>267</sup> 1 TEX. ADMIN. CODE § 70.3(b)(2)(G).

<sup>268</sup> Texas Comptroller, *Biennial Property Tax Report* - Tax Years 2020 and 2021, pg. 10.

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.<sup>269</sup>

### **What did 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.

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 taxing unit of the rate adopted.”<sup>270</sup> 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 of “unused tax increments” from the three preceding years if the city adopted a rate lower than the voter-approval rate in any of those years.<sup>271</sup>

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<sup>269</sup> TEX. TAX CODE § 26.05(a).

<sup>270</sup> Id.

<sup>271</sup> Id. § 26.013.

Most cities under 30,000 in population must keep their adopted property tax rate below the “de minimis rate” to avoid an automatic election.<sup>272</sup> The de minimis rate is the rate necessary to generate an additional \$500,000 in property tax revenue over the previous year.<sup>273</sup> The de minimis rate can be significantly higher than the voter-approval rate.

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.<sup>274</sup> In some smaller cities, the voters may be able to petition for an election under certain circumstances.<sup>275</sup>

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.<sup>276</sup>

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 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.<sup>277</sup>

### **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.<sup>278</sup> 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

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<sup>272</sup> Id. § 26.07(b).

<sup>273</sup> Id. § 26.012 (8-a)(B).

<sup>274</sup> Id. § 26.07.

<sup>275</sup> Id. § 26.075.

<sup>276</sup> Tex. Att’y Gen. Op. No. GA-1073 (2014).

<sup>277</sup> *Denman v. Quin*, 116 S.W.2d 783 (Tex. Civ. App.—San Antonio 1938, writ ref’d).

<sup>278</sup> TEX. CONST. art. XI, § 5.



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.<sup>279</sup> 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.<sup>280</sup> 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.<sup>281</sup>

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.<sup>282</sup> 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 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.<sup>283</sup> 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.<sup>284</sup> If the city adopts a tax rate that does not exceed the voter-

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<sup>279</sup> Id. § 4

<sup>280</sup> Id. § 5.

<sup>281</sup> TEX. TAX CODE § 302.001(b).

<sup>282</sup> TEX. LOC. GOV'T CODE § 51.051(b).

<sup>283</sup> Id. § 22.039.

<sup>284</sup> TEX. TAX CODE § 26.05(a).

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.<sup>285</sup>

The chief appraiser must deliver the certified appraisal roll to the tax assessor for the city by July 25 of each year.<sup>286</sup> Alternatively, if the appraisal review board has not approved the appraisal records by July 20, 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 25.<sup>287</sup> 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.<sup>288</sup>

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.”<sup>289</sup> 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.

### **Should a city official or staff member contact the appraisal district regarding property values?**

No. A member of the governing body, officer, or employee of a taxing unit commits a Class A misdemeanor if the person directly or indirectly communicates with the chief appraiser or another employee of the appraisal district for the purpose of influencing the value at which property in the district is appraised.<sup>290</sup> There is an exception if the person actually owns or leases the property that is the subject of the communication.

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

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.<sup>291</sup> 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 29 deadline. Cities that do not meet the September 29 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.<sup>292</sup> 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

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<sup>285</sup> Id.

<sup>286</sup> Id. § 26.01(a).

<sup>287</sup> Id. § 26.01(a-1).

<sup>288</sup> Id. § 26.04(c-2).

<sup>289</sup> TEX. LOC. GOV’T CODE § 102.009(a).

<sup>290</sup> TEX. TAX CODE § 6.155

<sup>291</sup> TEX. ELEC. CODE § 3.005(c).

<sup>292</sup> TEX. TAX CODE § 26.05(c).

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.<sup>293</sup>

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

No. 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.<sup>294</sup>

The lone public hearing may not be held before the fifth day after the date the notice of the public hearing is given.<sup>295</sup> 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).<sup>296</sup> 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.<sup>297</sup>

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.<sup>298</sup> A city that fits this criteria can elect to provide simplified notice authorized by state statute, which also authorizes the city to 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.<sup>299</sup>

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, [tml.org](http://tml.org) (Click “Policy” → Click “Legal Research” → Click “+” next to “Topics” → Click “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?**

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<sup>293</sup> Id. § 26.05(a).

<sup>294</sup> Id. § 26.05(d).

<sup>295</sup> Id. § 26.06(a).

<sup>296</sup> Id. § 26.05(d-1).

<sup>297</sup> Id. § 26.05(d-2).

<sup>298</sup> Id. § 26.052(a).

<sup>299</sup> Id. § 26.052(d).

A city may only levy property taxes in accordance with its budget.<sup>300</sup> 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.<sup>301</sup>

## 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.** 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 revenue from property taxes on existing property as last year, after taking into account changes in appraisals.<sup>302</sup>

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 tax revenue.

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 focuses on whether the actual number of dollars generated by property taxes goes up or down on an individual property, after taking into account appraisal fluctuations. As the foundation for city tax rate calculations, the no-new-revenue rate accomplishes this goal by generating a rate that would raise the same number of dollars as the prior year, making any increases in revenue more transparent.

Additionally, the legal effect of the no-new-revenue tax rate is very important. In the first place, a city can adopt a tax rate equal to (or less than) the no-new-revenue rate without as many additional requirements. 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.<sup>303</sup> 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

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<sup>300</sup> TEX. LOC. GOV'T CODE § 102.009.

<sup>301</sup> Id. §§ 102.005(b) & (c), 102.006(c), and 102.007(c).

<sup>302</sup> TEX. TAX CODE § 26.04(c)(1).

<sup>303</sup> Id. § 26.05(d).

rate) percent increase in the tax rate.”<sup>304</sup> Also, detailed published notice must be made of the tax increase hearing.<sup>305</sup>

At least 60 percent of the members of the governing body of a city must vote in favor of an ordinance setting a property tax rate that exceeds the no-new-revenue tax rate.<sup>306</sup> Most general law 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.

- (2) **No-New-Revenue Maintenance and Operations 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.<sup>307</sup> 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.
- (3) **Voter-Approval 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.”<sup>308</sup> Put another way, it is a rate that would raise precisely 3.5 percent more revenue from property taxes for maintenance and operations as the year before after taking into account appraisal fluctuations plus any “unused increment.”

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.

- (4) **Unused Increment Rate.** The unused increment rate is a component of the larger voter-approval rate calculation. If the city adopts tax rates lower than the voter-approval rate, the city has the ability to “bank” these unused amounts to use for up to three years. The unused increment rate is the 3-year rolling sum of the revenue the city could have collected with that year’s voter approval rate minus the revenue the city did collect with its nominal rate divided by current total value.<sup>309</sup> Under no circumstance can the unused increment rate be less than zero.<sup>310</sup>

The legislature’s stated goal in relation to the unused increment rate is to discourage taxing units from automatically adopting a rate equal to the 3.5 percent voter-approval rate every year. Under the new framework, a city that experiences exceptional growth

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<sup>304</sup> Id. § 26.05(b).

<sup>305</sup> Id. §§ 26.04(e), 26.06(b-1) – (b-3), 26.061, 26.062, and 26.063.

<sup>306</sup> Id. § 26.05(b).

<sup>307</sup> Id. § 26.012(18).

<sup>308</sup> Id. § 26.04(c)(2)(B).

<sup>309</sup> See ID.§ 26.013 (as amended by S.B. 1999 of the 88th Leg. R.S. Effective Jan. 1, 2024).

<sup>310</sup> TEX. TAX CODE § 26.013(b)(1).

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 likely 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.

- (5) **De Minimis Rate.** The de minimis rate is a tax rate calculation designed to give smaller taxing units, including cities, additional ability to raise revenue from property tax above the 3.5 percent increase included in the 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.<sup>311</sup>

In a nutshell, the de minimis rate allows smaller cities 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 revenue ceiling in very small communities would unnecessarily restrict revenue growth to sometimes just a nominal amount, creating 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.<sup>312</sup>

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, including the level of the tax increase, that the voters would be required to petition for a tax approval election instead of the city being required to hold an automatic election.<sup>313</sup>

- (6) **Proposed Tax Rate.** The proposed tax rate is the rate that the city council anticipates adopting while still working through the budget process.
- (7) **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," "gross rate;" or "adopted rate."

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<sup>311</sup> Id. § 26.012(8-a).

<sup>312</sup> Id. § 26.07(b).

<sup>313</sup> Id. § 26.075(b).

- (8) **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.
- (9) **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. To be eligible for inclusion in this tax rate, the debt service must fit within the definition of “debt” in Section 26.012 (7) of the Texas Tax Code.
- (10) **Emergency Revenue Rate.** If a city is located in an area declared a disaster area by the governor or the president of the United States, the city may adopt an tax rate that raises 8 percent more revenue over the previous year’s rate without voter approval, if at least one person is granted a temporary property tax exemption for a portion of the appraised value of property damaged by the disaster.<sup>314</sup> The city can continue to calculate the tax rate in this manner until the first year in which total taxable value of property exceeds the value on January 1 of the year when the disaster was declared or the third tax year after the disaster occurred. If a city adopts such a rate, in the first tax year following the last tax year for which the city adopted the disaster-related rate, the city’s voter approval rate is reduced by the “emergency revenue rate.”<sup>315</sup> The emergency revenue rate subtracts out from the voter-approval rate the cumulative effect the disaster-related rates would continue to have on the no-new-revenue rate moving forward. Effectively, the emergency revenue rate calculation puts the city’s tax rate where it would have been had the city adopted the voter-approval rate for each tax year when the city adopted a disaster-related rate.

**What happens if voters do not 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.<sup>316</sup> 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.<sup>317</sup>

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.”<sup>318</sup>

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<sup>314</sup> Id. § 26.042.  
<sup>315</sup> Id. § 26.042(b).  
<sup>316</sup> Id. § 26.07(e).  
<sup>317</sup> Id. § 26.07(g).  
<sup>318</sup> Id. § 26.07(c).

## **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 less revenue from property 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, with an inverse correlation to what property values have done in the meantime. A city may always adopt the no-new-revenue rate as its actual rate, without facing a tax rate approval election. It is a 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, because given the lower property values, the city would not be taking in any more revenue from property taxes than it did the year before even with a significantly higher rate.

## **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.<sup>319</sup>

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

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<sup>319</sup> 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.<sup>320</sup> 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.<sup>321</sup> 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.<sup>322</sup>

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.<sup>323</sup> 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.<sup>324</sup>

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.<sup>325</sup>

- (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.<sup>326</sup>

“Freeport property” includes certain types of tangible personal property that is detained in Texas for assembling, storing, manufacturing, or processing, only to be transported

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<sup>320</sup> TEX. TAX CODE § 11.13(n).

<sup>321</sup> Id.

<sup>322</sup> Op. Tex. Att’y Gen. No. KP-0215 (2018).

<sup>323</sup> TEX. TAX CODE § 11.13(d).

<sup>324</sup> Id.

<sup>325</sup> Id. § 11.13(f).

<sup>326</sup> TEX. CONST. art. VIII, § 1-j(b).

outside the state within 175 days after the property was first acquired in the state.<sup>327</sup> 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.<sup>328</sup>

- (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.<sup>329</sup>

Freeport property is typically warehouse inventory and manufacturing materials that pass through the state in less than 175 days.<sup>330</sup> Legislation passed in 2021 allows a city to extend this deadline to 270 days if the city is located in an area designated as a disaster area.<sup>331</sup> That legislation is set to expire December 31, 2025.

- (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.<sup>332</sup> 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.<sup>333</sup>
- (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.<sup>334</sup> 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.<sup>335</sup> Additionally while not technically an exemption, when appraising a residence in a historic district, the chief appraiser must consider the effect

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<sup>327</sup> Id. § 1-j(a).

<sup>328</sup> Id. § 1-j(d).

<sup>329</sup> TEX. TAX CODE § 11.253.

<sup>330</sup> TEX. CONST. art. VIII, § 1-j(a).

<sup>331</sup> TEX. TAX CODE § 11.253(l).

<sup>332</sup> Id. § 11.252(a).

<sup>333</sup> Id. § 11.252(f).

<sup>334</sup> Id. § 11.24(a).

<sup>335</sup> Id. § 11.24(b).

on the property's value of any restriction placed by the historic district on the property owner's ability to alter, improve, or repair the property.<sup>336</sup>

- (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 on which approved water conservation initiatives, desalination projects, or brush control initiatives have been implemented.<sup>337</sup>
- (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 60<sup>th</sup> day after the date the governor first declares territory in the taxing unit to be a disaster area.<sup>338</sup> If the governor declares the disaster prior to the city's adoption of the tax rate, then the exemption is automatic.<sup>339</sup>

### **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.<sup>340</sup>

### **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.<sup>341</sup>

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<sup>336</sup> Id. § 23.013(e).

<sup>337</sup> Id. § 11.32.

<sup>338</sup> Id. § 11.35(c).

<sup>339</sup> Id. § 11.35(b).

<sup>340</sup> TEX. CONST. art. VIII, § 1-b(h); see also TEX. TAX CODE § 11.261.

<sup>341</sup> TEX. TAX CODE § 11.261(b).

### **Is there a deadline to pass a city tax freeze?**

No. A tax freeze enacted anytime in tax year 2021 is fully effective to freeze tax bills at the 2021 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 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 constitution is clear that the tax freeze is permanent once enacted.<sup>342</sup>

### **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 are not 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.<sup>343</sup>

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

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<sup>342</sup> TEX. CONST. art. VIII, § 1-b(h).

<sup>343</sup> Id. § 26.012(6)(B).

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.<sup>344</sup>

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

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.<sup>345</sup>

### **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.<sup>346</sup> However, *Corrigan v. Newago*, another federal case, concludes otherwise.<sup>347</sup> 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).<sup>348</sup>

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<sup>344</sup> TEX. TAX CODE § 11.261(g).

<sup>345</sup> Id. § 26.045.

<sup>346</sup> *Gonzales v. Sinton*, 319 F. Supp. 189 (1970).

<sup>347</sup> *Corrigan v. Newago*, 55 F.3d 1211 (1995).

<sup>348</sup> TEX. TAX CODE § 11.14(a).

A city may choose to apply its property tax to such goods, however, after following certain procedures.<sup>349</sup>

### **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 10<sup>th</sup> day prior to the hearing and ending with the actual date of the hearing.<sup>350</sup>
- (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.<sup>351</sup>
- (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.<sup>352</sup>
- (5) **Resolution or Order Taxing Goods.** After the hearing and finding above, the council adopts a resolution taxing the otherwise exempt tangible personal property.<sup>353</sup>
- (6) **Notify Appraisal District and Tax Collector.**

## **PRO RATA FEES**

### **What are pro rata fees?**

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<sup>349</sup> Id. § 11.14(c).

<sup>350</sup> Id. § 11.14(e).

<sup>351</sup> Id.

<sup>352</sup> Id.

<sup>353</sup> Id. § 11.14(c).

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.

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.<sup>354</sup> 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.

## **PUBLIC IMPROVEMENT DISTRICT ASSESSMENTS**

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<sup>354</sup> TEX. LOC. GOV’T CODE § 395.001(4)(D).

## What is a Public Improvement District?

A public improvement district (PID) is a special district within a city or the city's extraterritorial jurisdiction covering a defined geographical area. The purpose of the district is to establish a funding source that the owners of property in the district can use to jointly make authorized improvements in the district. The creation of PIDs is authorized by Chapter 372 of the Texas Local Government Code.

## What are PID assessments?

PID assessments, also known as special assessments, are fees levied against property owners who will benefit from assessment-financed improvements within the PID. While the improvements are public improvements, they must confer a special benefit to the PID.<sup>355</sup> Assessments provide the mechanism to charge the costs of certain authorized public improvements to landowners within the PID.<sup>356</sup>

The list of "authorized improvements" allowed to be funded by a public improvement project includes: (1) landscaping; (2) the erection of fountains, distinctive lighting, and signs; (3) construction and improvement of sidewalks; (4) acquisition and installation of art; (5) acquisition, construction, or improvement of off-street parking facilities and mass transit; (6) the establishment or improvement of parks; and (7) similar projects.<sup>357</sup>

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 unilaterally 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 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.<sup>358</sup>

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.

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<sup>355</sup> Id. § 372.003(a).

<sup>356</sup> Id. § 372.003(b).

<sup>357</sup> Id. § 372.003.

<sup>358</sup> Id. § 372.005(b).



(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.<sup>359</sup>

(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.<sup>360</sup>

(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.<sup>361</sup> The advisory body, or other entity in its absence, is responsible for preparing a minimum five-year service plan upon creation of the district.<sup>362</sup>

(5) **Hearing on Creation of District.** The city council must hold a public hearing prior to establishing a public improvement district and levying assessments.<sup>363</sup> 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.<sup>364</sup> 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.<sup>365</sup> 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.<sup>366</sup>

(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 an “improvement order.”<sup>367</sup> The improvement order authorizing the district must be filed with the county clerk of each county in which the PID is located.<sup>368</sup> Construction of an improvement may not begin until after the 20<sup>th</sup> day following the filing of the improvement order.<sup>369</sup> 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 filing of the authorization.<sup>370</sup>

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<sup>359</sup> Id. § 372.006.

<sup>360</sup> Id. § 372.007.

<sup>361</sup> Id. § 372.008.

<sup>362</sup> Id. § 372.013.

<sup>363</sup> Id. § 372.009(a).

<sup>364</sup> Id. § 372.009(c).

<sup>365</sup> Id.

<sup>366</sup> Id. § 372.009(d).

<sup>367</sup> Id. § 372.010(a).

<sup>368</sup> Id. § 372.010(b).

<sup>369</sup> Id. § 372.010(c).

<sup>370</sup> Id.

(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.<sup>371</sup> 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.<sup>372</sup> The amount of assessment may be adjusted following an annual review of the service plan.<sup>373</sup>

(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.<sup>374</sup> The roll must be filed with the city secretary, and is an open record.<sup>375</sup>

(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.<sup>376</sup> Newspaper notice of the hearing must be published at least 10 days prior to the hearing.<sup>377</sup> The city secretary must also mail notice of the assessment hearing to each affected property owner.<sup>378</sup> At the hearing, each and every objection lodged against the assessment must be voted on by the council.<sup>379</sup>

(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.<sup>380</sup> The ordinance or order must specify the method of payment, which can include periodic installments.<sup>381</sup>

### 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;

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<sup>371</sup> Id. § 372.015.

<sup>372</sup> Id. § 372.015(b).

<sup>373</sup> Id. § 372.015(d).

<sup>374</sup> Id. § 372.016(a).

<sup>375</sup> Id. § 372.016(b).

<sup>376</sup> Id.

<sup>377</sup> Id.

<sup>378</sup> Id. § 372.016(c).

<sup>379</sup> Id. § 372.017(a).

<sup>380</sup> Id. § 372.017(b).

<sup>381</sup> Id.

water and wastewater facilities; drainage facilities; parks; other similar projects; and the “development, rehabilitation, or expansion of affordable housing.”<sup>382</sup>

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.<sup>383</sup>

### **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.<sup>384</sup> The lien is superior to all other liens except for non-payment of property taxes.<sup>385</sup> 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.<sup>386</sup>

### **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.<sup>387</sup> After receipt of the petition, the city council calls a hearing.<sup>388</sup> 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.<sup>389</sup> No procedures are specified in the chapter for levying this tax.

### **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.<sup>390</sup> The concept of a tourism PID was first introduced in Texas

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<sup>382</sup> Id. § 372.003.

<sup>383</sup> Id.

<sup>384</sup> Id. § 372.018(b)(3).

<sup>385</sup> Id. § 372.018(b)(2).

<sup>386</sup> Id. § 372.018(e); Tex. Att’y Gen. Op. No. JC-0386 (2001).

<sup>387</sup> TEX. LOC. GOV’T CODE § 372.011.

<sup>388</sup> Id.

<sup>389</sup> Id. § 372.021.

<sup>390</sup> Id. § 372.0035.

in 2011 when legislation passed authorizing a tourism PID only in the City of Dallas. Legislation passed in 2019 allows any city in Texas to create a tourism PID.<sup>391</sup>

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.<sup>392</sup> 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.<sup>393</sup>

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.<sup>394</sup>

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<sup>391</sup> Id. (as added by H.B. 1136 of the 86<sup>th</sup> Leg. R. S. Effective June 14, 2019).

<sup>392</sup> Id. §§ 372.0035(b) and (c).

<sup>393</sup> Id. §§ 372.005(b-1).

<sup>394</sup> Id. §§ 372.0035(d).

## **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.<sup>395</sup>

### **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 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 for how the fee is calculated and assessed. For those entities that do not gain access to a city’s right-of-way under state law, such as use of the right-of-way to install or maintain fiber optic cable, the city may require a right-of-way license agreement and negotiate rental costs for use of the right-of-way.

## **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. 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 under Chapter 66 of the Texas Utilities Code. Chapter 66 has several provisions, some of which are complex. Essentially, the law:

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<sup>395</sup> TEX. CONST. art. III, § 52.

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);<sup>396</sup>
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;<sup>397</sup> 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 revenue or, at the city's election, the per-subscriber line fee that was paid under previous franchise agreements.<sup>398</sup>

Every Texas city should now be compensated pursuant to a SIFCA from each provider. However, due to recent legislation, S.B. 1152, codified under Chapter 283 of the Local Government Code, cities might not receive right-of-way rental fees from certain providers in a given year.<sup>399</sup> Chapter 283 of the Texas Local Government Code and Chapter 66 of the Texas Utilities Code provide that a "bundled" cable and telecommunications provider is exempt from paying the lower of either its statewide cable right-of-way rental fees or state-wide telephone access line fees.<sup>400</sup> By October 1<sup>st</sup> of each year, the provider must file a written notification with each city of which fee will be exempted.<sup>401</sup>

### **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;<sup>402</sup> 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."<sup>403</sup>

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 revenue fund to comply with the law, which states that the city "may not comingle" PEG fees "with any other money."<sup>404</sup>

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<sup>396</sup> TEX. UTIL. CODE § 66.003.

<sup>397</sup> Id. § 66.005.

<sup>398</sup> Id. § 66.006.

<sup>399</sup> TEX. LOC. GOV'T CODE § 283.051 ; TEX. UTIL. CODE §66.005(d).

<sup>400</sup> TEX. UTIL. CODE § 66.005(d).

<sup>401</sup> TEX. LOC. GOV'T CODE §283.051(f) ; TEX. UTIL. CODE § 66.005(f)

<sup>402</sup> TEX. UTIL. CODE § 66.006(c-1).

<sup>403</sup> Id. § 66.006(c-2).

<sup>404</sup> Id. § 66.006(c-2)(2).

### **What if the 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.<sup>405</sup> Federal law provides that the fee must be used for “capital costs for PEG facilities.”<sup>406</sup> 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 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 ELECTRIC UTILITIES**

### **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.<sup>407</sup> 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.<sup>408</sup> 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.<sup>409</sup> 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

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<sup>405</sup> Id. § 66.006(c).

<sup>406</sup> 47 U.S.C. § 521, *et seq.* (Federal Cable Law).

<sup>407</sup> Senate Bill 7, 76<sup>th</sup> Legislature, Regular Session (1999).

<sup>408</sup> TEX. UTIL. CODE § 33.008(B)

<sup>409</sup> Id.

compensation.<sup>410</sup> (Note: Some cities may still collect a gross receipts franchise fee from electric cooperatives and municipal electric utilities.<sup>411</sup>)

If a city is already collecting a fee from the electric utility for the use of the right-of-way for the delivery of electricity to retail electric customers, the city may not require a franchise or an amendment to a franchise or require an additional charge, fee or tax from the utility for use of the right-of-way for middle mile broadband service.<sup>412</sup> If the city is not already collecting a fee from the electric utility for use of the right-of-way, the city may impose a fee on the provision of middle mile broadband service, but the charge may not be greater than the lowest charge that the city imposes on other providers of broadband service for use of the right-of-way in its jurisdiction.<sup>413</sup>

### **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.<sup>414</sup> 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 or [legalinfo@tml.org](mailto:legalinfo@tml.org).

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

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.<sup>415</sup>

### **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.<sup>416</sup>

### **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.<sup>417</sup>

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<sup>410</sup> Id.

<sup>411</sup> Id. § 33.008(f).

<sup>412</sup> Id. § 43.101(e).

<sup>413</sup> Id. § 43.101(f).

<sup>414</sup> Id. § 33.008(b).

<sup>415</sup> Id. § 33.008(d).

<sup>416</sup> Id.

<sup>417</sup> Id. § 33.008(g).



### **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.<sup>418</sup> 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.<sup>419</sup>

## **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:

*(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:

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<sup>418</sup> Id. § 33.008(f).

<sup>419</sup> Id. § 33.008(e).

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.<sup>420</sup> Gas companies do have a right to cross under city streets, however, subject to direction by the city.<sup>421</sup>

## **RIGHT-OF-WAY RENTAL FEES ON SMALL CELL NODES**

**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.<sup>422</sup> A city may adjust the amount of the public right-of-way rate not more often than annually by an amount equal

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<sup>420</sup> TEX. NAT. RES. CODE § 111.022; TEX. UTIL. CODE § 103.002.

<sup>421</sup> TEX. UTIL. CODE §§ 181.005 and 181.006.

<sup>422</sup> TEX. LOCAL GOV’T CODE § 284.053.

to one-half the annual change, if any, in the consumer price index.<sup>423</sup> (A cell company may also have to pay additional fees for “transport service” to connect a node to the network using fiber.<sup>424</sup>)

**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 locations;<sup>425</sup>
2. Create an “attachment agreement” governing how nodes are attached to city facilities;<sup>426</sup> and
3. Create “design districts” that can have more stringent aesthetic requirements.<sup>427</sup>

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?**

Several cities are arguing in court that it is not. The City of McAllen is leading a coalition of around 57 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. A Travis County district court ruled in favor of the State of Texas, denying the cities’ motion for summary judgment. The cities have appealed the decision, which is currently pending before the Third Court of Appeals.<sup>428</sup>

It should be noted that as a practical matter, any immediate impact of the court’s ruling on SB 1004 may be minimal because of the current Federal Communications Commission’s order that effectively capped small-cell right-of-way rental fees at \$270—barely above the S.B. 1004 limit of \$250.<sup>429</sup> The FCC order was challenged by numerous local governmental entities but was upheld by the Ninth Court of Appeals on June 28, 2021.<sup>430</sup>

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<sup>423</sup> Id. § 284.054.

<sup>424</sup> Id. § 284.055.

<sup>425</sup> Id. § 284.108.

<sup>426</sup> Id. § 284.201.

<sup>427</sup> Id. § 284.105.

<sup>428</sup> *City of McAllen v. State of Texas*, No. 03-22-00524-CV (Tex. App.- Austin Aug. 24, 2022).

<sup>429</sup> *Accelerating Wireless Broadband Deployment by Removing Barriers to Infrastructure Inv.*, 33 FCC Rcd. 9088 (2018) and *Accelerating Wireless Broadband Deployment by Removing Barriers to Infrastructure Inv.*, 33 FCC Rcd. 7705, 7775–91 (2018)

<sup>430</sup> *City of Portland v. United States*, 969 F.3d 1020, 1032 (9th Cir. 2020), *cert. denied*, 141 S.Ct. 2855 (2021).

## **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.<sup>431</sup> Added to this compensation is one-half of the annual change, if any, in the consumer price index.<sup>432</sup>

### **How are right-of-way rental fees on “bundled” cable and telecommunications providers calculated?**

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.<sup>433</sup> By October 1 of each year, the provider must file a written notification with each city of which fee will be eliminated.<sup>434</sup>

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<sup>431</sup> Id. § 283.055(f).

<sup>432</sup> Id. § 283.055(g).

<sup>433</sup> Id. § 283.051(d).

<sup>434</sup> Id. § 283.051(f).

A coalition of cities, led by the cities of McAllen, Dallas, and Houston, have filed a lawsuit challenging the constitutionality of [S.B. 1152](#). The legislation eliminated over \$100 million annually in rights-of-way fees from cable and telecom providers. A Travis County Court granted the cities' motion for summary judgment and declared that S.B. 1152 violates the prohibition on public gifting of things of value to private persons under Article III, Section 52, of the Texas Constitution. On August 24, 2022, the State of Texas appealed the decision to the Third Court of Appeals, where it is presently pending.<sup>435</sup>

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

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.<sup>436</sup> 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.<sup>437</sup>

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

Such a municipality must 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.<sup>438</sup>

### **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?**

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<sup>435</sup> *State of Texas v. City of McAllen*, No. 03-22-00524-CV (Tex. App.- Austin Aug. 24, 2022).

<sup>436</sup> Id. § 283.054(a).

<sup>437</sup> Id.

<sup>438</sup> Id. § 283.053.

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”) that 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 wholly or partly in a county with a population of 5,000 or more may adopt the tax.<sup>439</sup>

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

The tax is levied only within the boundaries of a crime control and prevention district.<sup>440</sup> A district may consist of all or a part of the corporate boundaries of a city that creates it.<sup>441</sup> 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.<sup>442</sup>

### **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.<sup>443</sup> However, the total combined tax rate within the city may not exceed two percent.<sup>444</sup>

### **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;

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<sup>439</sup> Id. § 363.051(a).

<sup>440</sup> Id. § 363.054(b)(6).

<sup>441</sup> Id. § 363.051(b).

<sup>442</sup> Id. § 363.181.

<sup>443</sup> Id. § 363.055(a).

<sup>444</sup> Id. § 363.055(a) and TEX. TAX CODE § 321.101(f).

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 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.<sup>445</sup>

### **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.<sup>446</sup> The seven-member board is appointed by the city council, however.<sup>447</sup>

### **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.<sup>448</sup> 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.<sup>449</sup>

## **SALES TAXES FOR DEDICATED PURPOSES**

### **What are sales taxes for dedicated purposes?**

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<sup>445</sup> TEX. LOC. GOV’T CODE § 363.151.

<sup>446</sup> Id. § 363.154(e).

<sup>447</sup> Id. § 363.101(a).

<sup>448</sup> Id. § 363.053.

<sup>449</sup> Id. §§ 363.051(a) and 363.054(a).

This manual refers to all city sales taxes other than the sales tax for general revenue as sales taxes for dedicated purposes. Revenue from each tax other than the sales tax for general revenue may be spent only 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 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.<sup>450</sup>

### **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.<sup>451</sup> 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?**

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<sup>450</sup> TEX. TAX CODE § 321.406.

<sup>451</sup> Id. § 321.409.



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.<sup>452</sup> To make sure that the city properly words its ballot proposition, local legal counsel should be consulted. The TML Legal Department (512-231-7400 or 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.

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<sup>452</sup> Id. § 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 in 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 in 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.<sup>453</sup> All cities with room under the cap are eligible to adopt a Type B sales tax.<sup>454</sup>

## **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.<sup>455</sup>

## **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.<sup>456</sup> The combined rate of all local sales taxes within the city, however, cannot exceed two percent.<sup>457</sup> 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.

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<sup>453</sup> TEX. LOC. GOV'T CODE § 504.002.

<sup>454</sup> Id. § 505.002.

<sup>455</sup> Id. §§ 504.255(a) and 505.251.

<sup>456</sup> Id. §§ 504.252(b) and 505.252(b).

<sup>457</sup> Id. §§ 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.<sup>458</sup> 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.”<sup>459</sup> 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.<sup>460</sup>

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.<sup>461</sup>

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.<sup>462</sup>

Type B sales taxes for economic development (but not Type A) may be spent on: (1) sports stadiums<sup>463</sup> (Type A taxes may be spent on stadiums only after an election<sup>464</sup>); (2) entertainment and convention facilities<sup>465</sup>; (3) city parks<sup>466</sup>; (4) affordable housing<sup>467</sup>; 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.<sup>468</sup>

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<sup>458</sup> Id. §§ 505.156 and 505.158(a).

<sup>459</sup> Id. § 501.001.

<sup>460</sup> Id. § 501.002(12).

<sup>461</sup> Id. §§ 504.105 and 505.103.

<sup>462</sup> Id. § 501.103.

<sup>463</sup> Id. § 505.152.

<sup>464</sup> Id. § 504.152.

<sup>465</sup> Id. § 505.152.

<sup>466</sup> Id. § 505.152.

<sup>467</sup> Id. § 505.153.

<sup>468</sup> Id. §§ 505.156 and 505.158(a).

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

The city itself does not spend 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.<sup>469</sup>

## **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.<sup>470</sup> 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?**

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<sup>469</sup> Id. § 501.073.

<sup>470</sup> TEX. TAX CODE § 321.103(a).

The sales tax for general revenue is adopted by an election of the city voters.<sup>471</sup> 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<sup>472</sup>; 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.<sup>473</sup>

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.<sup>474</sup> Specific ballot language is required by statute.<sup>475</sup>

**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.<sup>476</sup> 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.<sup>477</sup> 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.<sup>478</sup> The comptroller then remits the city its portion of the taxes at least twice a year (though it is done more often in practice).<sup>479</sup>

The comptroller keeps two percent of city sales taxes as payment for the state’s services in collecting the tax.<sup>480</sup> 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.

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<sup>471</sup> Id. § 321.101(a).

<sup>472</sup> Id. § 321.401(a) and (b).

<sup>473</sup> Id. § 321.101(c).

<sup>474</sup> Id. § 321.403.

<sup>475</sup> Id. § 321.404.

<sup>476</sup> Id. § 321.409.

<sup>477</sup> House Bill 3046, 85th Legislature, Regular Session (2017).

<sup>478</sup> TEX. TAX CODE § 321.301.

<sup>479</sup> Id. § 321.502.

<sup>480</sup> Id. § 321.503.

## **May the city’s general revenue sales tax be pledged to pay off bonds?**

Generally not.<sup>481</sup> Excepted from this prohibition, however, are certain sports and community venue projects.<sup>482</sup>

## **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.<sup>483</sup> The city must request the information within 90 days of discovering the reallocation or refund.<sup>484</sup>

## **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 other states that didn’t disclose that data. Whether or not this would happen in practice is debatable.

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<sup>481</sup> Id. § 321.506.

<sup>482</sup> Id. § 321.508.

<sup>483</sup> Id. § 321.510(b).

<sup>484</sup> Id. § 321.510(f).

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.<sup>485</sup> 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.<sup>486</sup>

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.<sup>487</sup> 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.<sup>488</sup> A city council may meet in executive session to receive information about such confidential data.<sup>489</sup>

### **May a city rebate municipal sales taxes?**

Yes. Cities may offer sales tax rebates and refunds for a period of up to ten years in neighborhood empowerment zones and North American Free Trade Agreement Impact Zones.<sup>490</sup> 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 in a state enterprise zone.<sup>491</sup>

### **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.<sup>492</sup> This sourcing rule is true even where the bulk of the business operations take place elsewhere. The comptroller promulgated rules to take effect in October of 2020 that would have sourced local sales tax to the location of the buyer rather than the seller, but those rules were enjoined by a court on procedural grounds. As of the publication of this manual, the comptroller is in the process of revising the local sales tax sourcing rules.

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<sup>485</sup> Id. § 321.3022(a-1).

<sup>486</sup> Id. § 321.3022(a-2).

<sup>487</sup> Id. § 321.3022(b).

<sup>488</sup> Id. § 321.3022(f).

<sup>489</sup> Id. § 321.3022(i).

<sup>490</sup> TEX. LOC. GOV’T CODE §§ 378.004(2) and 379.004.

<sup>491</sup> TEX. GOV’T CODE § 2303.505.

<sup>492</sup> 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.<sup>493</sup>

### **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.<sup>494</sup>

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).<sup>495</sup>

Garbage collection service is subject to the state and local sales tax as a taxable real property service.<sup>496</sup> 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.<sup>497</sup> 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.<sup>498</sup> 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.<sup>499</sup> 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.<sup>500</sup> This includes satellite T.V.<sup>501</sup>

Telecommunications services are generally subject to state sales taxes.<sup>502</sup> 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.<sup>503</sup>

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<sup>493</sup> Id. § 321.002(a)(3).

<sup>494</sup> Id. § 151.315.

<sup>495</sup> Id. § 151.0048(a)(3).

<sup>496</sup> Id. §§ 151.0048(a)(3) and 151.0048(b).

<sup>497</sup> Id. § 151.317.

<sup>498</sup> Id. § 151.317(a)(1).

<sup>499</sup> Id. § 321.105.

<sup>500</sup> Id. § 151.0101(a)(2).

<sup>501</sup> 34 TEX. ADMIN. CODE § 3.133.

<sup>502</sup> TEX. TAX CODE § 151.0101(a)(6).

<sup>503</sup> Id. §§ 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.<sup>504</sup> 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.<sup>505</sup>

### **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.<sup>506</sup> The combined rate of all local sales taxes within the city, however, cannot exceed two percent.<sup>507</sup>

### **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

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<sup>504</sup> Id. § 321.210.

<sup>505</sup> Id. § 321.507.

<sup>506</sup> Id. § 321.103(b).

<sup>507</sup> Id. § 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.<sup>508</sup>

### **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.<sup>509</sup> 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.<sup>510</sup>

### **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.”<sup>511</sup>

## **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.<sup>512</sup> 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.<sup>513</sup>

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<sup>508</sup> Id. § 321.401(a) and (d).

<sup>509</sup> Id. § 26.041.

<sup>510</sup> Id. § 321.507(a).

<sup>511</sup> Id. § 321.507.

<sup>512</sup> Id. § 327.004.

<sup>513</sup> Id. § 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.<sup>514</sup> 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.<sup>515</sup> 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.<sup>516</sup>

### **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.<sup>517</sup> 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**

### **Are gas and electricity use subject to state and city sales taxes?**

Gas and electricity sold for most commercial uses are subject to both state and city sales tax.<sup>518</sup> Industrial, agricultural, and manufacturing uses are typically exempt.

Residential use of gas and electricity are exempt from state sales tax and is ordinarily exempt from city sales tax.<sup>519</sup> However, any city that imposed sales tax prior to October 1, 1979, and chose to retain sales tax on residential use of gas and electricity on or before May 1, 1979, may charge sales tax on residential use of gas and electricity.<sup>520</sup> Additionally, a city that adopted a sales tax prior to

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<sup>514</sup> Id. § 327.006.

<sup>515</sup> Id. § 327.007(a).

<sup>516</sup> Id. §§ 327.007(a)(2-a) and (3).

<sup>517</sup> Id. § 327.008.

<sup>518</sup> Id. § 151.317.

<sup>519</sup> Id. § 151.317(b).

<sup>520</sup> Id. § 321.105; 34 Tex. Admin. Code § 3.334(l).

October 1, 1979, and did not choose to maintain a sales tax on residential use of gas and electricity may reimpose the sales tax at any time.<sup>521</sup> To reimpose the sales tax, the city must adopt an ordinance by majority vote of the membership of the city council.<sup>522</sup> The vote must be a record vote and recorded in the minutes of the city.<sup>523</sup> Finally, the city must send a copy of the ordinance to the comptroller by registered or certified mail.<sup>524</sup>

If the city had no sales tax prior to October 1, 1979, it may not impose city sales tax on residential use of gas and electricity.<sup>525</sup>

### **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.<sup>526</sup> The phrase “of the membership,” indicates 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 a general 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.<sup>527</sup>

### **How many Texas cities have repealed the tax exemption on residential gas and electricity?**

According to 2022 comptroller data, about 785 cities have repealed the exemption on residential gas and electricity. That leaves well over a hundred cities that are eligible to repeal the exemption

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<sup>521</sup> TEX. TAX CODE § 321.105.

<sup>522</sup> Id.

<sup>523</sup> Id.

<sup>524</sup> Id.

<sup>525</sup> TEX. ADMIN. CODE § 3.334(1).

<sup>526</sup> TEX. TAX CODE § 321.105(c).

<sup>527</sup> Id. § 321.105(d).

but have not done so.<sup>528</sup> The comptroller maintains a list of cities that have repealed the exemption<sup>529</sup> and a list of cities that are eligible to do so but have not.<sup>530</sup>

## **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.

Telecommunications services are generally subject to state sales taxes.<sup>531</sup> 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.<sup>532</sup>

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.<sup>533</sup> 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.<sup>534</sup>

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<sup>528</sup> <https://comptroller.texas.gov/taxes/sales/utility>

<sup>529</sup> <https://comptroller.texas.gov/taxes/sales/utility/cities.php>

<sup>530</sup> <https://comptroller.texas.gov/taxes/sales/utility/cities-eligible.php>

<sup>531</sup> Id. § 151.0101(a)(6).

<sup>532</sup> Id. §§ 151.323 and 151.325.

<sup>533</sup> Id. §§ 321.210.

<sup>534</sup> Id. § 151.0103.

### **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.<sup>535</sup>

### **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.<sup>536</sup>
- (2) Record the votes in the minutes of the city council.<sup>537</sup>
- (3) The city secretary must send a copy of the ordinance to the comptroller by certified or registered mail.<sup>538</sup>

### **How many Texas cities impose sales taxes on telecommunication services?**

According to 2023 comptroller data, 538 cities have repealed the tax exemption and impose sales taxes on telecommunication services.<sup>539</sup>

## **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).<sup>540</sup> No procedures are specified in the chapter for levying this tax. See Chapter: *Assessments*.

## **STREET ASSESSMENTS**

### **What are street assessments?**

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<sup>535</sup> 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.

<sup>536</sup> TEX. TAX CODE § 321.210(b).

<sup>537</sup> Id. § 321.210(d).

<sup>538</sup> Id. § 321.210(d).

<sup>539</sup> <https://comptroller.texas.gov/taxes/publications/96-339.php>

<sup>540</sup> TEX. LOC. GOV'T CODE § 372.021.

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*.

### **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.<sup>541</sup>

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.<sup>542</sup> This peculiar statute thus limits the amount of street assessments in home rule cities to the financial benefit on the adjoining land, which is likely lower than the cost of the street improvement.

Home rule cities may also levy assessments for opening (building), extending, or widening new city streets following eminent domain of the right-of-way.<sup>543</sup> The city's share of street construction shall be no more than one-third of the total cost, with the landowner paying two-thirds.<sup>544</sup>

### **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.<sup>545</sup>

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.<sup>546</sup> The landowners must be permitted to pay their two-thirds cost assessment in not fewer than five equal, annual payments.<sup>547</sup> The assessment constitutes a lien against the property.<sup>548</sup>

### **Is there any other authority for a city to levy street assessments?**

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<sup>541</sup> TEX. TRANSP. CODE § 311.091(a).

<sup>542</sup> Id. § 311.091(a).

<sup>543</sup> Id. § 311.092.

<sup>544</sup> Id. § 311.092(b).

<sup>545</sup> Id. § 311.095(a).

<sup>546</sup> Id. § 311.095(b).

<sup>547</sup> Id. § 311.095(c).

<sup>548</sup> Id. § 311.095(f).

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 improved.<sup>549</sup> 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.<sup>550</sup> 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.<sup>551</sup>

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.<sup>552</sup> 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 21<sup>st</sup> day before the hearing date.<sup>553</sup> 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.<sup>554</sup>

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.<sup>555</sup>

## **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.”<sup>556</sup> Time warrants are non-negotiable instruments that are issued to

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<sup>549</sup> Id. § 313.042(a).

<sup>550</sup> Id. §§ 313.042(b) and (c).

<sup>551</sup> Id. § 313.042(d).

<sup>552</sup> Id. §§ 313.024, 313.047, and 313.048.

<sup>553</sup> Id. § 313.047.

<sup>554</sup> Id. § 313.047(f).

<sup>555</sup> Id. § 313.042(e).

<sup>556</sup> TEX. LOC. GOV'T CODE § 252.001(8).



obtain property or labor on credit, and are delivered to the contractor rather than sold for cash.<sup>557</sup> 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?**

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.<sup>558</sup> 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.<sup>559</sup>

### **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.<sup>560</sup>

### **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.<sup>561</sup>

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<sup>557</sup> 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).

<sup>558</sup> TEX. LOC. GOV'T CODE § 252.045(a).

<sup>559</sup> Id. § 252.023.

<sup>560</sup> Id. § 252.041(d).

<sup>561</sup> TEX. GOV'T CODE § 1202.007(a)(4).

## **TRAFFIC FINE REVENUE**

### **Is there a limit on how much city revenue can come from traffic fines?**

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.<sup>562</sup>

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.<sup>563</sup> 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.<sup>564</sup> Failure to properly send the reports to the comptroller results in the city being responsible for the costs of any audit.<sup>565</sup>

### **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.<sup>566</sup>

### **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 most 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.

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<sup>562</sup> TEX. TRANSP. CODE § 542.402(b).

<sup>563</sup> Id. § 542.402(c).

<sup>564</sup> Id. § 542.402(d).

<sup>565</sup> Id. § 542.402(e).

<sup>566</sup> Id. § 542.402(b).

## USER FEES

### **What are user fees?**

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.<sup>567</sup> 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.<sup>568</sup> Nor may a city attach a mandatory fee in water bills to pay for volunteer fire fighting services.<sup>569</sup>

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<sup>567</sup> *Vance v. Town of Pleasanton*, 261 S.W. 457, 458 (Tex. Civ. App.—San Antonio 1924).

<sup>568</sup> Op. Tex. Att'y Gen. No. JM-338 (1985).

<sup>569</sup> Op. Tex. Att'y Gen. No. GA-84 (2003).

For instance, a recent Texas Supreme Court case clarified that a city may not charge a license fee calculated as a percentage of the business's revenue.<sup>570</sup> A percentage-of-revenue fee is based on fluctuating market forces rather than recovery of the cost of regulation, so the court noted that fixed amount or volume-based fees are appropriate.

## **UTILITY FEES**

### **How much may cities charge as utility fees?**

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 a reasonable profit from operation of their utility system.<sup>571</sup> 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.<sup>572</sup>

### **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.<sup>573</sup> 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.

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<sup>570</sup> *Builder Recovery Services, LLC v. Town of Westlake*, 650 S.W.3d 499 (Tex. 2022), reh'g denied (Sept. 2, 2022).

<sup>571</sup> *San Antonio Ind. S.D. v. City of San Antonio*, 550 S.W.2d 262, 264 (Tex. 1976).

<sup>572</sup> *San Antonio*, *supra*, at 265, citing *State v. Southwestern Bell Tel. Co.*, 526 S.W.2d 526 (Tex. 1975).

<sup>573</sup> Op. Tex. Att'y Gen. No. H-1289 (1978).

## 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.

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.<sup>574</sup> The term also includes convention and civic centers, civic center hotels, auditoriums, museums, plazas, and parks in the vicinity of a convention center facility.<sup>575</sup>

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.<sup>576</sup>

## 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.<sup>577</sup> However, the total combined tax rate within the city may not exceed two percent.<sup>578</sup> 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.<sup>579</sup> 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.<sup>580</sup>
- (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.<sup>581</sup> Revenue from the motor vehicle rental tax may not be used to finance a parks and

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<sup>574</sup> TEX. LOC. GOV'T CODE § 334.001(4)(A).

<sup>575</sup> Id. § 334.001(4)(B).

<sup>576</sup> Id. § 334.001(4)(D), (E), and (F).

<sup>577</sup> Id. § 334.083.

<sup>578</sup> Id. § 334.082(a) and TEX. TAX CODE § 321.101(f).

<sup>579</sup> TEX. LOC. GOV'T CODE § 334.085.

<sup>580</sup> Id.

<sup>581</sup> Id. §§ 334.101 and 334.103.

- recreation system that would otherwise qualify as a venue project.<sup>582</sup> 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.<sup>583</sup>
- (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.<sup>584</sup> A city may impose a parking tax only if the city issues bonds or other obligations to finance the venue project.<sup>585</sup>
  - (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.<sup>586</sup> 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.<sup>587</sup> 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.<sup>588</sup>
  - (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.<sup>589</sup> 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.<sup>590</sup>
  - (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.<sup>591</sup>
  - (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.<sup>592</sup> 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.<sup>593</sup>

## How are venue taxes levied?

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<sup>582</sup> Id. § 334.1015.

<sup>583</sup> Id. § 334.112(b).

<sup>584</sup> Id. § 334.202.

<sup>585</sup> Id. § 334.205(b).

<sup>586</sup> Id. § 334.254.

<sup>587</sup> Id. §§ 334.2515 and 334.2517.

<sup>588</sup> Id. § 334.257(b).

<sup>589</sup> Id. § 334.303.

<sup>590</sup> Id. § 334.302(b).

<sup>591</sup> Id. § 334.404.

<sup>592</sup> Id. § 334.152.

<sup>593</sup> Id. § 334.151(b).

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.<sup>594</sup>

Prior to the election, the Texas Comptroller must determine that the venue project and accompanying taxes won’t negatively impact state revenue.<sup>595</sup> This process is triggered once the city council adopts a resolution authorizing the project and submits the resolution to the comptroller.<sup>596</sup> 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.<sup>597</sup> The city has 10 days to appeal the comptroller’s decision.<sup>598</sup>

### **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.<sup>599</sup>

### **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.<sup>600</sup> 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.<sup>601</sup> A city has the discretion to deposit various other sources of revenue associated with a venue project into the fund.<sup>602</sup> A city is required to establish separate accounts within the fund for the various revenue sources.<sup>603</sup>

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.<sup>604</sup>

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<sup>594</sup> Id. § 334.024.

<sup>595</sup> Id. § 334.022.

<sup>596</sup> Id. § 334.021.

<sup>597</sup> Id. § 334.022.

<sup>598</sup> Id. § 334.023.

<sup>599</sup> Tex. Att’y. Gen. Op. No. GA-0156 (2004).

<sup>600</sup> TEX. LOC. GOV’T CODE § 334.042(a).

<sup>601</sup> Id. § 334.042(b).

<sup>602</sup> Id. § 334.042(c).

<sup>603</sup> Id. § 334.042(a).

<sup>604</sup> Id. § 334.042(d).