The Texas Economic Development Sales Tax: A Primer for Local Officials  
2005 Update

Overview

Over the years, the economic development sales tax has become the backbone of local efforts to bring new jobs and investment to Texas communities. The tax was created in 1989 by legislation authored by State Senator Bill Ratliff of Mount Pleasant to give smaller Texas communities the financial resources to build effective economic development programs and offer financial incentives to attract primary jobs.

As of July 2005, voters in 537 Texas communities have approved the tax—more than half of which have less than 5,000 residents. The broader 4B tax continues to be the more popular choice for Texas communities. As of July 2005, 318 cities have passed the 4B tax, compared to 122 cities with the 4A tax. Nearly 100 cities impose both the 4A and 4B tax.

Recent Changes to the Economic Development Sales Tax

Economic development is about primary jobs and wealth creation. That’s why the Texas Legislature passed HB 2912 in 2003. The legislation, which was supported by the TEDC, eliminated loopholes in the DCA that enabled Texas communities to use 4A and 4B tax revenues in ways never envisioned, such as building fire stations and city halls.

In 2005, Texas lawmakers passed legislation (HB 2928), which reinserted the loopholes that were eliminated back in 2003. Although the TEDC remained neutral on language in HB 2928 that granted small, rural communities additional flexibility to attract retail development, our members strongly opposed “carve out” language that gave certain Dallas-Fort Worth area and border communities their own set of rules.

Changes affecting communities with fewer than 20,000 residents

Early supporters of the economic development sales tax never intended that it be used to support retail development. Nonetheless, over the years, rural communities have embraced the economic development sales tax as a tool to attract retail establishments to their communities.

HB 2928 included language that makes it easier for economic development corporations created by cities with less than 20,000 residents to spend 4B revenues on direct incentives to promote new and expanded business development. The law requires that cities approve by resolution, after two separate readings, expenditures of this nature that exceed $10,000. The new rules enable these small communities to directly finance retail development projects, such as offering cash grants or incentives to a Walmart store or Red Lobster restaurant. Although the TEDC does not believe this is the most effective use of economic development sales tax revenues (because retail is a secondary economic activity), we remained neutral on this provision of HB 2928 because we understand the challenges facing rural Texas communities.

KEY TERMS

The Development Corporation Act of 1979 (DCA) is the law that regulates the use of the economic development sales tax. The DCA is found in Article 5190.6 of Vernon’s Civil Statutes. Sections 4A, 4B, and 4C of the DCA relate to the economic development sales tax.

Economic Development Corporations are the legal entities with the statutory authority to spend economic development sales tax dollars. The corporations are city-chartered and governed by a city-appointed board of directors. Corporations are typically referred to either as “4A” or “4B” depending on the type of economic development sales tax uses approved by local voters.

Primary Jobs are jobs that infuse new dollars into the local economy by creating or selling a product or service that is ultimately exported to regional, statewide, national, or international markets.
Special Interest Carve-Outs

Perhaps the most potentially damaging aspect of HB 2928 are the various geographic carve-outs. Certain communities in the border region and the Dallas-Fort Worth area succeeded in winning language that allows them to play by their own set of rules. For example:

- Certain “land-locked” economic development corporations in Dallas and Harris counties are now authorized to use 4B revenues to finance direct incentives for retail development projects. Essentially, the provision enables a handful of suburban communities to operate under the rules established to address the needs of rural Texas.

- Certain economic development corporations near the border are now authorized to spend 4A and 4B revenues for the development or expansion of general airport facilities.

- Economic development corporations in Hidalgo County are now authorized to spend 4A and 4B revenues on sewer or solid waste disposal facilities, airports, and ports.

- Economic development corporations in Hidalgo County may now issue Industrial Revenue Bonds (IRBs) for infrastructure projects that do not create primary jobs.
The Economic Development Sales Tax: Working for Texas

The economic development sales tax is the state’s largest and most effective local revenue source for economic development. The best way to protect the tax for years to come is to use it with caution, care, and common sense.

The Texas Economic Development Council (TEDC) will continue to advocate, educate, and inform economic development professionals on developments related to the tax, including best practices and statutory changes. TEDC members will also closely monitor special interests that have their eye on the tax as a funding source for local projects that fall outside the scope of economic development, such as hospitals and community colleges.

Other useful resources on the economic development sales tax can be found at:

- “Handbook on Economic Development Laws for Texas Cities,” 2004. This publication, produced by the Intergovernmental Relations Division of the Office of the Attorney General, provides a comprehensive legal and technical overview of major economic development laws, including the economic development sales tax. The full report can be downloaded from publications page of the Office of the Attorney General’s web site at www.oag.state.tx.us. Note: This version of the report does not include changes enacted by the 2005 Texas Legislature.

- “Economic Development Sales Tax,” June 2004 (Publication #96-302). This brochure provides a technical summary of the economic development sales tax, including detailed information on how communities must administer the tax. The brochure can be downloaded from the Comptroller’s web site under tax information/tax publications.


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