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.

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.

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.

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 economic development sales tax 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 DCA defines a ***primary job*** *as a job that is: (1) available at a company for which a majority of the products or services of that company are ultimately exported to regional, statewide, national, or international markets, infusing new dollars into the local economy; and (2) included in one of the following sectors of the North American Industry Classification System (NAICS).*

111	Crop Production
112	Animal Production
113	Forestry and Logging
11411	Commercial Fishing
115	Support Activities for Agriculture and Forestry
211-213	Mining
221	Utilities
311-339	Manufacturing
42	Wholesale Trade
48-49	Transportation and Warehousing
51	Information, excluding movie theaters (51213) and drive-in theaters (512132)
523-525	Securities, Commodity Contracts, and Other Financial Investments and Related Activities; Insurance Carriers, Related Activities; Funds, Trusts, and Other Financial Vehicles
5413, 5415, 5416,	Scientific Research and Development Services
5417, and 5419551	Management of Companies and Enterprises
56142	Telephone Call Centers (NEW)
922140	Correctional Institutions
928110	National Security (NEW)

Legislative History

Over the past 15 years, Texas lawmakers have passed dozens of laws pertaining to the economic development sales tax. One of the most significant changes was the creation of the "4B" tax in 1991, which broadened eligible uses of economic development sales tax revenues from traditional economic development activities to community development.

The Texas Legislature has amended Section 4A of the DCA 27 times and Section 4B 36 times. Major legislative changes to the economic development sales tax statute are presented in the timeline below.

1979

Development Corporation Act passed, authorizing cities to create economic development corporations.

1989

4A tax authorized to provide funding source for recruiting and retaining manufacturing and industrial projects.

1991

4B tax authorized for broader community development projects.

1993

Number of cities eligible to impose 4B tax expanded.

1997

- State reporting requirement enacted.
- 4A corporations authorized to undertake 4B projects with voter approval.

1999

Allowable 4A and 4B projects expanded to include targeted infrastructure, job creation and retention, job training, and educational facilities.

Differences Between the 4A and 4B Economic Development Sales Tax.

This practitioners guide offers a quick snapshot of what you can do with economic development sales tax dollars. It is in no way intended to substitute for the advice and counsel of your local attorney or the in-depth training materials you receive at one of the TEDC's regional training seminars.

4A Eligible Projects

Land, buildings, equipment, facilities, improvements, and expenditures related to:

- Manufacturing, industrial, research & development, recycling, small warehouse and corporate headquarter facilities, and distribution centers.
- Closed or realigned military bases.
- Job training for primary jobs and commercial/retail.
- Business airport facilities and port-related facilities.
- Clean up of contaminated project sites (with a special election and specific ballot language).
- Infrastructure assistance to retail or commercial projects.
- Business-related sewer utilities and site improvements. **NEW**
- Beach remediation in Gulf of Mexico communities required or suitable to promote or develop new or expanded business enterprises. **NEW**
- Projects designed to attract new military missions, prevent the closure of existing missions, and redevelop a closed or realigned military base. **NEW**
- General airport facilities for communities located 25 miles from US/Mexico border only. **NEW**
- 4B projects with voter approval.

4B Eligible Projects

- Everything authorized under 4A of the DCA, including retail and commercial projects with the same restrictions.
- Water supply facilities (with a special election and specific ballot language).
- Projects that improve a community's quality of life, including parks, professional and amateur sport and athletic facilities, tourism and entertainment facilities, affordable housing, and other improvements or expenditures that promote new or expanded business activity that create or retain primary jobs.
- Projects designed to attract new military missions, prevent the closure of existing missions, and redevelop a closed or realigned military base. **NEW**
- Solid waste disposal facilities in Hidalgo County. **NEW**
- Direct incentives for retail development in communities with fewer than 20,000 residents and certain land-locked cities in Dallas and Harris counties.

2001

- Allowable 4A and 4B projects expanded to include research and development facilities.
- Allowable 4B projects expanded to include water and water conservation programs.
- Training requirement for 4A/4B corporations and city officials established.

2003

- Allowable 4A and 4B projects narrowed to exclude educational facilities, learning centers and municipal buildings.
- "Primary jobs" language inserted into DCA, limiting retail incentives to infrastructure, job training, and promotional expenditures.
- Performance contract requirement established.

2005

- Restrictions on retail incentives removed for certain Texas communities.
- Allowable 4A and 4B projects expanded to include certain sewer utilities and site improvements.
- Call centers added to definition of primary jobs.
- Cities authorized to determine the number and term of office (up to six years) of 4A corporation directors, and remove a 4A corporation director at any time without cause.
- Allowable use of 4A and 4B revenues expanded for military related projects.

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.

The Texas Economic Development Council has proudly been the most vocal and effective supporter of the economic development sales tax since its creation.

- **"Economic Development Corporation Report, Fiscal Years 2002 and 2003,"** 2004. This report, published every two years by the Comptroller of Pubic Accounts, analyzes expenditures made by 4A and 4B development corporations. The report is produced to comply with legislative reporting requirements established by HB 1410 in 1999. The full report may be downloaded from Comptroller's web site at: http://www.window.state.tx.us/lga/edcr0003/.

- **"Texas Economic Development Incentives,"** March 2003. A special report that includes chapters on the economic development sales tax and public economic development corporations. The full report may be downloaded from the Comptroller's web site at: http://www.cpa.state.tx.us/specialrpt/ecodev03/.

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