

May 2007

**Legal Q&A**

**By Bennett Sandlin, TML General Counsel**

**What is a municipal development district sales tax?**

A municipal development district (MDD) sales tax is an optional city sales tax that closely resembles a 4B economic development sales tax. It can be levied within a specified area of the city or its extraterritorial jurisdiction.

**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. TEX. LOC. GOV'T CODE § 377.104. The combined rate of all local sales taxes within the district, however, cannot exceed two percent. TEX. LOC. GOV'T CODE § 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 Section 4B(a) of the Development Corporation Act. In other words, the MDD tax automatically encompasses any project available to a similarly-sized 4B economic development corporation;
- 2) A convention center facility or related improvements, such as a civic center or auditorium;
- 3) Parking lots for such convention or related facilities; or
- 4) Civic center hotels. 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. TEX. LOC. GOV'T CODE § 377.001.

**If the MDD sales tax so closely resembles a 4B economic development sales tax, why not just enact a 4B economic development tax instead?**

There are several distinctions between an MDD tax and a 4B 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 4B sales tax (see above);
- 2) An MDD sales tax need not be levied over the entire corporate limits of a city, as a 4B 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.” 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) An MDD sales tax may be imposed in a city’s extraterritorial jurisdiction (ETJ) if the voters of the entire district approve the tax. TEX. LOC. GOV’T CODE § 377.002(2). 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 4B statute does. For example, the 4B statute prevents the city from giving aid to the 4B corporation. TEX. REV. CIV. STAT. ANN. art. 5190.6, § 21. The MDD statute contains no such restriction. The MDD statute only references the 4B law to define the permissible projects of an MDD; it does not incorporate the other procedural and substantive aspects of the 4B statute; and
- 5) The board of an MDD consists of a minimum of four persons. A 4B corporation has a seven-member board. Many 4B cities, particularly smaller cities, report difficulty in locating persons willing to serve on the 4B board. The smaller MDD board can help in this regard.

**The ability of a 4B corporation to fund commercial and retail economic development projects depends on the size and/or 4B 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 4B laws that contains the population/revenue distinction with respect to commercial and retail projects. TEX. LOC. GOV’T CODE § 377.001(3)(A).

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 4B 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.

MDDs that don’t meet either of those criteria would be limited to 4B 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. 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?**

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 municipal development district (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 to allow voting for or against using 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.”; 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).

- 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 #1 above at a properly noticed public meeting.
- 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 second Saturday in May, or the first Tuesday after the first Monday in November).
- 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.
- 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. 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 council members, 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.

- 6) Establish Development Project Fund. The board of the MDD then must pass a resolution establishing the “development project fund.” It is into this fund that the sales tax proceeds are deposited and spent on authorized MDD projects (see above).

**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. TEX. LOC. GOV'T CODE § 377.0739(a).