



# **TEA Update on School District Tax Compliance**

**TEA Division of Financial Compliance**

## Excerpt from an Attorney General opinion regarding school district rollback tax rates:

### S U M M A R Y

Subsection 26.08(a) of the Tax Code requires the registered voters of an independent school district to approve an adopted tax rate if the governing body of the district adopts a tax rate that exceeds the district's rollback tax rate. The rollback rate calculation, defined in subsection 26.08(n), includes a maximum maintenance and operations tax rate component and a current debt service tax rate component. The debt service component of the rollback rate does not reflect the debt service tax rate of the preceding year but of the current year. As a result, the rollback tax rate effectively measures only the maintenance and operations component of the tax rate.

An independent school district may not increase a maintenance and operations tax rate above the maximum maintenance and operations tax rate component calculated for purposes of the rollback tax rate without voter approval through a tax ratification election.

Case history: the district wanted to lower its overall ad valorem tax rate by 2 cents. The district proposed to achieve this by reducing its debt service rate 4 cents while raising its M&O rate 2 cents.

In this opinion, the AG said, "Districts do not have authority to increase the M&O tax rate to create a surplus to pay debt service with M&O tax revenue."

[AG Opinion KP-0154](#)

See also [AG Opinion GA-0775](#)

# HB 3 Tax Policy Changes

- Effective January 1, 2020, requires **Efficiency Audits** before a district seeks voter approval for increasing tax rates. LBB establishes guidelines. Districts must select the auditor **at least** four months **before** the scheduled tax increase election date; the audit must be completed and posted on the district's website at least 30 days before the election.
  - New statutory language clarifies that a school district may not increase the M&O tax rate in order to create a surplus for the purpose of paying the district's debt service. (I.e. No more "swap and drops" or "tax swaps")
  - Tax Ratification Elections (TREs) must happen on uniform election days.
  - Bond election notices must include "THIS IS A PROPERTY TAX INCREASE" language
- [TEC §11.184](#)
  - [TEC §45.0021](#)
  - [Texas Tax Code §26.08](#)
  - [TEC §45.003](#)

## TEC §45.0021 – Restriction on Maintenance Tax Levy

Effective Date: September 1, 2021

A school district may not levy (increase the rate of) the district's maintenance taxes described by Section 45.002 at a rate intended to create a surplus in maintenance tax revenue for the purpose of paying the district's debt service.

Source: TEC §45.0021(a)

# M&O Rate Offset by Decreased I&S Rate

Section 20 of H.B. 1525 amended Section 45.0021 of the Texas Education Code to prevent districts from adopting an increased Maintenance and Operations (M&O) tax rate offset by a decreased Interest and Sinking (I&S) tax rate while the total tax rate remained the same.

$$\begin{array}{l} \text{M\&O} \\ \text{rate} \end{array} \uparrow \quad \begin{array}{l} \text{I\&S} \\ \text{rate} \end{array} \downarrow \quad = \quad \begin{array}{l} \text{no change in} \\ \text{total tax rate} \end{array}$$

# Surplus in Maintenance Tax Revenue

**What is meant by “a rate intended to create a surplus in the maintenance tax revenue for the purpose of paying the district’s debt service”?**

A district required to have an I&S fund intentionally adopts a low I&S (debt service) tax rate and then compensates for it by increasing the M&O tax rate. The result is the revenue generated from the I&S tax rate cannot support the district’s annual debt payment without an additional transfer from the maintenance and operations fund.

## Example of a district intentionally adopting a low I&S tax rate:

A district adopts a low I&S (debt service) tax rate and then compensates for it by increasing the M&O tax rate.

The local General Fund revenue gained from the increased M&O tax rate in some cases raises additional Tier II funding which more than equally offsets the local revenue lost in the Debt Service Fund by the decreased I&S tax rate.

The increased local funds from the M&O tax rate was transferred from the General Fund (as a surplus) to the Debt Service Fund to cover the loss of the decreased I&S funds due to the offsetting lower I&S tax rate.

**\*\*\*These activities are not allowable under HB 1525.**

# Possible Exceptions

Cases where the I&S rate may not support the full bond payment, but it may not actually be a tax swap:

- External grants
- Use of fund balance / Bond payoff
- Existing Debt Allotment
- Instructional Facilities Allotment

In certain cases, the M&O tax rate may not provide enough revenue to pay the annual debt payment, but there are other sources available that may supplement the debt payment without a transfer.



## Ways that TEA identify tax swaps:

- ✓ AFR note disclosures by the auditor
- ✓ 8911 (transfers out) from the general fund to 7915 (transfers in) in the debt service fund
- ✓ Historical tax rate analysis (Exp.: M&O tax rate of \$1.04 in one year increased to \$1.17 the next year with a comparable change in the I&S tax rate that resulted in no change to the total tax rate)
- ✓ There is an insufficient amount in the I&S fund balance to cover the debt payment.

## **What time period will TEA use to look for tax swaps?**

- ❖ TEA will begin with the most recent year's data that the agency has available, which is currently the 2021-2022 school year
- ❖ TEA plans to send out letters later this Spring

# Sample Analysis

## Sample ISD tax analysis:

August 21 Submitted Property Value	\$	1,608,710,249
21-22 I&S Rate		0.1131
% Collections (Estimate Only)		0.9750
I&S Collections	\$	1,773,965
Debt Service	\$	(2,863,695)
EDA/IFA		0
Over / Short	\$	(1,089,730)
	\$	-
Collections / Debt Service (Percent Funded)		62%

# Acton Steps by TEA

- 1) Develop a method to identify school districts that may have adopted a maintenance tax rate in violation of TEC §45.0021(a), which must include a review of data over multiple years.
- 2) For each school district identified as possibly being in violation, investigate as necessary to determine whether the district has adopted a maintenance tax rate in violation of Subsection (a).

This includes:

- ✓ TEA will send a letter asking the district to explain why the district adopted a potentially low I&S tax rate.
- ✓ TEA will allow the district an opportunity to provide data to explain their budget preparation methodology.

Source: TEC §45.0021(c)

## Action Steps by TEA (cont.)

- 3) If TEA determines that a school district has adopted a maintenance tax rate in violation of TEC §45.0021(a):
  - A. Order the district to comply with Subsection (a) not later than three years after the date of the order; and
  - B. Assist the district in developing a corrective action plan that, to the extent feasible, does not result in a net increase in the district's total tax rate.

Source: TEC §45.0021(c)

# Further TEA Actions

- 4) TEA's Internet website will post a list of school districts that the agency has determined to have adopted a maintenance tax rate in violation of TEC §45.0021(a).

Source: TEC §45.0021(c)

# Failure to Take Corrective Action

If a school district fails to take action under a corrective action plan developed under Subsection (c)(3)(B), the commissioner may reduce the district's entitlement under Chapter 48 by an amount equal to the difference between:

- (1) the amount of state and local funding the district received as a result of adopting a maintenance tax rate in violation of Subsection (a); and
- (2) the amount of state and local funding the district would have received if the district had not adopted a maintenance tax rate in violation of Subsection (a).

Source: TEC §45.0021(e)

## Districts are not prohibited from:

- 1) Using a surplus in maintenance tax revenue to pay the district's debt service if:
  - A. the district's interest and sinking fund tax revenue is insufficient to pay the district's debt service due to circumstances beyond the district's control; and
  - B. the use of the surplus maintenance tax revenue to pay the district's debt service is necessary to prevent a default on the district's debt.

Source: TEC §45.0021(f)



## **Districts are not prohibited from (cont.):**

- 2) Paying a portion of the district's maintenance tax revenue into the tax increment fund for a reinvestment zone under Chapter 311, Tax Code; or
- 3) Using money disbursed from the tax increment fund for a reinvestment zone under Chapter 311, Tax Code, in accordance with the agreement entered into by the district with the governing body of the municipality or county that designated the zone under Section 311.013(f) of that code.

Source: TEC §45.0021(f)

## Final Note:

- ❖ If you are notified by TEA of a potential 1525 issue, compare TEA's data with your district's data. Please inform TEA of any discrepancies.
- ❖ TEA will work with ISD's to adopt correct tax rates.



# Financial Compliance Division Contacts

## **Peggy Watts**

Manager, Fiscal Reviews

[Peggy.Watts@tea.texas.gov](mailto:Peggy.Watts@tea.texas.gov)

## **Gary Micinski**

Financial Analyst – HB 1525 Tax  
Compliance

[Gary.Micinski@tea.texas.gov](mailto:Gary.Micinski@tea.texas.gov)

## **David Marx**

Director, Financial Compliance

[David.Marx@tea.texas.gov](mailto:David.Marx@tea.texas.gov)

## **Paul Moreno**

Asst. Director, Financial  
Compliance

[Paul.Moreno@tea.texas.gov](mailto:Paul.Moreno@tea.texas.gov)