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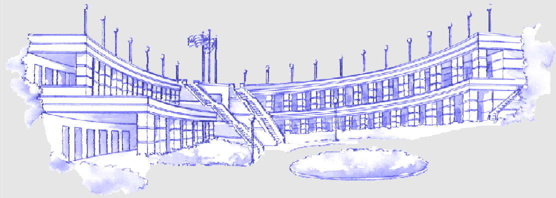
Policy Brief



Twenty Frequently Asked Questions about South Carolina Taxes (and Fees)

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1. Are our taxes in South Carolina high compared to other states?

According to the most commonly used measures, overall taxes in South Carolina are low in comparison to other states. South Carolina ranked 47th in combined state and local tax revenue per capita out of 50 states and the District of Columbia in 2002. In this measure of tax adequacy the state was 75.6 percent of the U.S. average.

South Carolina ranks in the bottom 20 percent of states in tax capacity. Measures of tax capacity estimate a state's ability to raise revenue from its overall tax base. Two common measures are personal income per capita (SC rank of 44 in 2004) and Gross State Product per capita (SC rank of 43 in 2004).

In two measures of tax burden South Carolina ranked 42nd in combined state and local tax revenue as a percent of personal income and 37th as a percent of Gross State Product.

Tax effort measures how much the state raises in tax revenue compared to how much it could raise given its tax base. South Carolina had a tax effort score of 90 in 1997, or 90 percent of the national average, for state and local taxes combined. For selected state taxes only, South Carolina had a tax effort score of almost 100 in 2004—right at the national average.

South Carolina state and local governments also collect nontax revenue from own sources, including service charges, various fees, and miscellaneous revenue. Examples include hospital fees, higher education tuition, admission to state parks, parking and police fines, solid waste fees, etc. When these nontax revenues are examined, the state ranks in the top 20 whether the measure is per capita revenue (20), revenue as a percent of personal income (13), or revenue as a percent of Gross State Product (14). So taxes are low in South Carolina, but nontax revenues are high in comparison to other states.

2. Are our property taxes high compared to other states?

South Carolina ranked 36th among the states in tax adequacy measured by property tax revenue per capita in 2002. The state collected $754 per capita compared to a national average of $969. In tax burden, the state ranked 27th in property tax revenue as a percent of personal income and 28th as a percent of Gross State Product.

Because the South Carolina property tax system assesses different kinds of property at different rates, different types of property will compare more or less favorably with others states. In general, because of the 4 percent assessment rate and school property tax relief, property taxes on owner-occupied residential property are lower in South Carolina than in most other states. Growth in property tax revenue has also been slower.

According to the Tax Foundation, between 1992 and 2002, local property tax revenue adjusted for inflation grew by 1.2 percent per year on average in the U.S.; for South Carolina, the growth rate was only 0.7 percent per year.

3. How do other states provide property tax relief?

Three-fourths of the states give some kind of property tax relief that is tied to income, or to how high taxes are in relation to income. Many states give tax relief to renters, because property taxes are reflected in the rent that they pay, even if they don't write the check to the county treasurer for taxes. In South Carolina, relief is provided to people over 65, to homeowners (school property taxes), and to new and expanding industry.

4. Do renters pay property taxes? Do they get any tax relief?

Renters don't write checks for property taxes. Landlords, or owners of rental property, write the check. But property taxes are a cost of ownership, along with maintenance, insurance, etc., so the landlord will pass on part or all of the cost of property taxes to the tenant.

When property taxes go up, rent goes up. So the burden of the tax falls on the tenant, even if the landlord gets to deduct it on his income taxes.

Property taxes on rental property are much higher than on comparable owner-occupied property, because the assessment rate is 6 percent instead of 4 percent (also true of second homes). And none of the relief from school taxes for homeowners or the homestead exemption for those over 65 is available to renters.

5. How important are tax incentives for industrial location in South Carolina?

Tax incentives are a consideration in making a location decision, and the state needs to be competitive. But taxes are a part of a larger package that includes infrastructure, location relative to suppliers and markets, labor force quality, energy costs, access to ports, and other considerations. Firms look for low taxes but they also look for quality public services, especially schools.

It is important to offer a tax package that is attractive, but not to give away so much revenue that there isn't enough to provide the public services that the new firm and its managers, employees and customers need and expect.

6. Why are property assessments going up so fast? What can we do to keep people from getting driven out of their homes by increases in property taxes?

Rising assessments are the result of a long boom in housing prices. As property values have skyrocketed, so have property assessments. South Carolina has a provision for rolling back the property tax (mill) rate at reassessment so that taxes don't rise nearly as much as home values, but there are a number of qualifications to the rollback requirement that have permitted property tax collections to rise as property values have risen.

Much of the increase in property taxes in recent years has been to fund the public schools because of increased state and federal requirements, rising costs, and diminished state and federal aid. Cities and counties have not raised their property tax rates very much. In fact, in many counties municipal and county tax collections have declined because of the local option sales tax.

7. What is a circuit breaker? How does it work?

A circuit breaker is a tax break, usually for property tax, that is based on income or on the tax burden in relation to the taxpayer's income. If the tax owed exceeds a certain percentage of income, the taxpayer gets a reduction or a rebate for some or all of the excess amount.

There are many ways of designing circuit breakers. Some work through income tax refunds. Some include renters, estimating the part of the rent that is due to property taxes.

A summary of circuit breakers and other property tax relief programs in other states is available at the Jim Self Center on the Future part of the Strom Thurmond Institute web site at: http://selfcenter.clemson.edu.

8. Can we increase the sales tax enough to eliminate the property tax?

Not really. The state's 5 percent retail sales tax currently raises about $2.3 billion a year for the state's General Fund and close to $600 million for the Education Improvement Act Fund. Property taxes—school, city, county, and special purpose district—likely raised over $4.5 billion a year in 2005.

If we doubled the state sales tax rate, revenue would not double because our sales tax rate would be high enough (well above the national average) to discourage in-state sales and encourage people to shop across state lines or by internet or catalog.

9. How do you know if a state has a good tax system? What makes one tax system better than another?

There are a number of ways of evaluating tax or revenue systems. The most widely used litmus tests are adequacy, efficiency, and equity. These tests can be applied to particular taxes or fees but really should be used to evaluate the system as a whole and how the system changes when particular taxes are added, removed, or changed.

- *Adequacy* is a measure of whether there is enough revenue for public purposes. A rough indicator of adequacy is how the state compares to other states in revenue per capita—the resources available to provide services per resident.
- *Equity* is a measure of fairness in distribution of the burden across income groups, or between homeowners and renters, households and business, young and old.
- *Efficiency* is a measure of whether a revenue system offers positive incentives and minimizes negative incentives to work, shop, locate and invest in the state.

10. Why is it important to have the "big three"—sales, income, and property taxes? Don't Florida and Tennessee manage pretty well without an income tax?

Florida manages fairly well because the state collects so much sales and excise tax from tourism. Tennessee has an extremely high sales tax rate (over 9 percent including local taxes) and very high property tax rates. Tennessee's high sales tax rate and lack of individual income tax has made the state's tax burden highly regressive (i.e., heavier on the poor) than South Carolina's tax burden. Only New Hampshire has no broad-based income or sales tax—instead, the state has high property and excise taxes and very limited public services. *No state has succeeded in doing away with the property tax.*

Forty of the 50 states, plus the District of Columbia, rely on a combination of income, sales, and property taxes. Doing so diversifies their tax portfolios and allows legislators to keep rates lower on each tax because it doesn't have to contribute such a large share of the total.

Also, each tax contributes something useful to the overall system. Income taxes make the system less regressive, sales taxes and property taxes offer more stability than income taxes, and property taxes link taxes to services that benefit property owners.

11. How much sales tax revenue could we raise from taxing services and eliminating exemptions instead of raising the rate?

It depends on the exemption and the service. Eliminating the sales tax cap on cars alone would raise about $100 million. Based on the experience of states with broader taxation of services, it might be possible to raise revenue by about $80 million from that source.

Depending on the choice of other exemptions and the range of service taxed, it might be possible to raise as much as $500 to $800 million in sales tax revenue more without raising the rate.

The other possibility is to comply with the standardized tax base and pressure Congress to relax the current limitations on taxation of internet sales, which would yield up to $125 million a year in additional revenue.

12. What are the pros and cons of raising taxes on gasoline and cigarettes? Who will be affected?

South Carolina has very low excise taxes on cigarettes (7 cents a pack) compared to the rest of the country (average 70 cents a pack). Gasoline taxes (16 cents a gallon) are low as well.

Excise taxes, which also include taxes on beer, wine and spirits, are different from sales taxes in being expressed as so many cents per unit (gallon, pack, liter, etc.). As prices rise, the value of the tax declines over time. The seven cent a pack tax on cigarettes, set in 1972, would have to be over 30 cents a pack today to have the same purchasing power. Income taxes rise automatically with inflation, and so do sales taxes. But unless excise taxes are indexed (automatically adjusted for inflation), the revenue from these taxes and the purchasing power of that revenue lags other revenue sources.

Higher taxes on cigarettes would discourage smoking, and higher taxes on gasoline would encourage conservation and reduce air pollution. The only downside is that these taxes tend to be more burdensome on the poor.

13. Are there some groups in South Carolina that get a better tax deal than others? Who and why?

The three groups currently most favored by the tax system in South Carolina are homeowners, people over age 65, and new industry.

The biggest differential is on the individual income tax, where a household earning $200,000 in South Carolina would pay 80 percent less in income tax if both adults were over 65 than if they were under 65.

Homeowners get tax relief on school property taxes and people over 65 get homestead exemption relief on city, count and school property taxes.

Owner-occupied houses are assessed at the lowest rate, 4 percent, while commercial and rental property and personal vehicles are assessed at 6 percent and other types of property at 9.5 percent and 10.5 percent. New industry can negotiate fee-in-lieu agreements that greatly reduce their taxes relative to existing industry.

When one group is favored, who is "disfavored?" Owners of commercial and rental property (and by extension, renters), older industrial property and business personal property are carrying an increasing share of the property tax burden in South Carolina.

14. Who carries the biggest tax burden in South Carolina—the rich, the poor, or the middle class?

The following table shows the distribution of the 2002 tax burden in South Carolina as a percent of personal income. The highest burden as a percent of income is in the income range of $22,000 to $35,000. It is slightly lower for families with lower incomes and substantially lower for households in the top 1 percent of the income distribution. The property tax burden is distributed fairly evenly, but the sales tax is burdensome on low income families and the income tax, while progressive, does not offset the sales tax.

Tax Burden as a Percentage of Personal Income, 2002

Annual Household Income Range, 2002	Percent of Households in Range	Sales Tax	Property Tax	Income Tax	Gross Total Tax	Net Total Tax*
Less than $13, 000	First 20%	5.5%	2.1%	0.3%	7.9%	7.9%
$13,000 to $22,000	Second 20%	5.1%	1.9%	1.3%	8.3%	8.2%
$22,000 to $35,000	Third 20%	4.3%	2.2%	2.5%	9.0%	8.8%
$35,000 to $59,000	Fourth 20%	3.6%	1.9%	3.2%	8.7%	8.4%
$59,000 to $110,000	Next 15%	2.7%	2.0%	4.1%	8.8%	7.7%
$110,000 to $232,000	Next 4%	1.8%	2.0%	4.7%	8.4%	6.7%
Over $232,000	Top 1%	0.9%	1.6%	5.2%	7.7%	5.5%

*After adjusting for federal deductibility of income & property taxes.
Source: Institute on Taxation and Economic Policy, 2003,

15. How much money does government need? How can we tell how much is enough?

There is no magic formula, but there are some guidelines. For example, researchers at the Federal Reserve Bank of Boston have computed an index of fiscal need for each state for 1997 that is based on such factors as poverty rates, miles of roadways, percent elderly, numbers of school children, etc. The average state would have an index of 100.

South Carolina's index of fiscal need is 97, meaning the state would need 97 percent of the average per capita revenue collections to adequately address the need for public infrastructure and services, based on what happens in other states. But in fact, South Carolina only collected about 76 percent of the national average in 2002.

The state ranks 47th in tax revenue per capita and 44th in own-source revenue (including fees, charges, and miscellaneous revenue) per capita. South Carolina ranks 8th out of 12 Southern states in per capita own-source revenue, ahead only of Tennessee, Arkansas, Mississippi, and Kentucky.

16. Can we count on our state revenue system to continue to produce enough revenue to pay for public services in South Carolina?

There are some risks to the South Carolina revenue system right now, even if there are no major changes made in the next few years.

An aging population means more income is coming from interest, dividends, pensions and social security than from wages and salaries. These income sources pay less in the way of income taxes than wages and salaries.

The sales tax grows more slowly than personal income, and is increasingly vulnerable to revenue losses because of internet and cross-border shopping.

Broadening the sales tax base by eliminating exemptions and covering more services, and reconsidering the treatment of retirement income are two issues that the General Assembly should consider in order to ensure a flow of state revenue in the future that is adequate to pay for public services.

17. Why did we have such a big drop and recovery in state revenue in the last five years? Why isn't state funding more stable?

South Carolina was not the only state to have that experience between 2001 and 2004, although it was one of those harder hit. The income tax is very sensitive to fluctuations in wages and salaries, so downturns affect income tax revenue significantly. Revenue from the sales tax is also affected by fluctuations in wages and salaries. The individual income tax and the general sales tax are the two primary sources of revenue to the state General Fund. Local sales taxes also provide revenue to local governments.

The state has attempted to cushion these swings in funding with reserve funds, but the reserve funds are small and quickly exhausted in a multi-year economic turndown.

The General Assembly has also engaged in the practice of funding recurring expenditures out of nonrecurring revenue—for example, using one-time money to pay for raises for state employees and then having to find money to pay it again the next year. This practice aggravates the decline in revenue when the economy is in a slump, because the General Assembly has to find a way to pay for those long-term commitments.

18. What is the state's share of the cost of K-12 education? How much of education funding comes from local property taxes?

The state pays just about 51percent of operating expenses—a little less if homeowners' school property tax relief is not counted as state aid to schools. About 38 percent of the funding comes from local property taxes and minor local sources like school fees, interest, asset sales, and building rentals. The rest comes from federal aid.

19. If property taxes are supposed to pay for services to property, why are they used to support the public schools? Shouldn't they just pay for fire, police, solid waste pickup, street maintenance, and things like that?

The only state where property taxes do not play a role in funding public education is Hawaii.

The value of residential property is closely linked to the quality of the schools that children from that neighborhood can attend. So homeowners have an interest in the quality of public schools even if they don't have children in public school. Furthermore, when the link between property taxes and schools is severed, as it was in California, support for public education declines.

If school districts are going to have some degree of flexibility and independence from the state to "customize" school quality to the needs and desires of their citizens, they have to have an independent revenue source. So far, the property tax has provided the most flexible (because the mill rate can be adjusted annually) and most stable source of local revenue for all local governments, and especially for school districts.

20. Why can't government be more like a business and pay for its services with fees from those who use them?

South Carolina actually does rely heavily on fees and charges—well above the national average. The state ranks 20th among the 50 states and the District of Columbia in per capita revenue from fees, charges, and miscellaneous sources.

For some services, it is appropriate to charge the users. Water and sewer are one example. Recreation programs, parking, and other services that are used only by some identifiable citizens lend themselves to paying a fee. So do hospital charges and college tuition.

But excessive reliance on fees and charges is hard on lower income households, because the fee is usually the same regardless of income, and low income families often rely more heavily on public services.

Charging a fee may discourage people from using services that benefit the whole community, like solid waste pickup and public education. And many public services—police protection and fire protection, street lights and street maintenance—are hard to charge to particular users.

A mix of taxes and fees for different kinds of services and different kinds of citizens/taxpayers makes more sense.

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